S. Hrg. 100-578, Vol. I

CONCURRENT RESOLUTION ON THE BUDGET FOR FISCAL YEAR 1989

HEARINGS

BEFORE THE

COMMITTEE ON THE BUDGET
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

NATIONAL SECURITY

MARCH 1, 1988—DEFENSE BURDEN-SHARING
MARCH 3, 1988—VIEWS OF THE SECRETARY OF DEFENSE
MARCH 18, 1988—DEFENSE LONG-RANGE STRATEGY

INTERNATIONAL AFFAIRS

MARCH 17, 1988—VIEWS OF THE SECRETARY OF STATE
MARCH 22, 1988—DIRECT FOREIGN INVESTMENT IN THE UNITED STATES

Volume I of III

Printed for the use of the Committee on the Budget

U.S. GOVERNMENT PRINTING OFFICE
84-099 WASHINGTON : 1988

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S251-4

COMMITTEE ON THE BUDGET

LAWTON CHILES, Florida, *Chairman*

ERNEST F. HOLLINGS, South Carolina
J. BENNETT JOHNSTON, Louisiana
JIM SASSER, Tennessee
DONALD W. RIEGLE, JR., Michigan
J. JAMES EXON, Nebraska
FRANK R. LAUTENBERG, New Jersey
PAUL SIMON, Illinois
TERRY SANFORD, North Carolina
TIMOTHY E. WIRTH, Colorado
WYCHE FOWLER, JR., Georgia
KENT CONRAD, North Dakota
CHRISTOPHER J. DODD, Connecticut

PETE V. DOMENICI, New Mexico
WILLIAM L. ARMSTRONG, Colorado
NANCY LANDON KASSEBAUM, Kansas
RUDY BOSCHWITZ, Minnesota
STEVEN D. SYMMS, Idaho
CHARLES E. GRASSLEY, Iowa
ROBERT W. KASTEN, JR., Wisconsin
DAN QUAYLE, Indiana
JOHN C. DANFORTH, Missouri
DON NICKLES, Oklahoma
WARREN B. RUDMAN, New Hampshire

RICHARD N. BRANDON, *Staff Director*
G. WILLIAM HOAGLAND, *Minority Staff Director*
W. THOMAS FOXWELL, *Director of Publications*

CONTENTS

HEARINGS

Page
March 1, 1988—Defense Burden Sharing 1
March 3, 1988—Views of the Secretary of Defense 61
March 17, 1988—Views of the Secretary of State 165
March 18, 1988—Defense Long-Range Strategy 231
March 22, 1988—Direct Foreign Investment in the United States 281

STATEMENTS BY COMMITTEE MEMBERS

Chairman Chiles 1, 61, 165, 231, 281
Senator Domenici 6, 63, 166, 233, 283
Senator Kasten 5
Senator Sasser 333

WITNESSES

Carlucci, Hon. Frank C., Secretary of Defense 64
Crowe, Adm. William J., Jr., USN, Chairman, Joint Chiefs of Staff 99
Hale, Robert F., Assistant Director for National Security Division, Congressional Budget Office 18
Ikle, Dr. Fred Charles, Cochairman, Commission on Integrated Long-Term Strategy 237
Kennedy, Prof. Paul, Dilworth Professor of History, Yale University 8
Kirkpatrick, Hon. Jeane J., Leavey Professor of Government, Georgetown University 39
Powell, James, New Canaan, CT, author of "Gnomes of Tokyo" 307
Shultz, Hon. George P., Secretary of State 167
Steinbruner, Dr. John D., The Brookings Institution 240
Tolchin, Dr. Susan, Professor of Public Administration, School of Government and Bussiness Administration, George Washington University 285

ADDITIONAL MATERIAL

Questions and answers—Committee members to witnesses, written:

Professor Kennedy 58
Secretary Carlucci 159

DEFENSE BURDEN-SHARING

TUESDAY, MARCH 1, 1988

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 2:05 p.m., in room SD-608, Dirksen Senate Office Building, Hon. Lawton Chiles (chairman of the committee) presiding.

Present: Senators Chiles, Hollings, Sasser, Lautenberg, Wirth, Conrad, Domenici, Boschwitz, Grassley, Kasten, and Danforth.

Staff present: Richard N. Brandon, staff director; and Douglas Cook, group leader for national security.

For the minority: G. William Hoagland, staff director; Richard Doyle, senior analyst for defense.

OPENING STATEMENT OF CHAIRMAN CHILES

Chairman **CHILES**. Good afternoon. Today we welcome to the committee three experienced and distinguished observers of the American condition.

Robert Hale is the assistant director of the National Security Division at the Congressional Budget Office. He has been a great help to this committee over the years, and we are certainly glad to have him with us.

We also look forward to welcoming former United Nations Ambassador Jeane Kirkpatrick. We understand that she will be joining us in just a few minutes. She has been and continues to be a very candid and knowledgeable analyst of U.S. foreign policy and has certainly served us well.

Finally, we are joined by Prof. Paul Kennedy, a historian and author of the thought-provoking bestseller, "The Rise and Fall of Great Nations."

Some years ago, another gifted author, Barbara Tuchman, said, "The overall responsibility of power is to govern as reasonably as possible in the interest of the State and its citizens." Those words from her book, "The March of Folly," underwrite the notion of government in this country. But in a world alive with ambition and change, the United States has found it harder and harder to know how best to use its power. At home, the pressures on government are legion. We are in debt, the deficits are high, and we have been through a hard era of arguments about how to distribute the funds we have.

Abroad, the pressures are just as intense, and the stakes are enormous. We have military commitments around the world. We are up against shifting threats from many countries.

To deal with the threats as we see them, the United States has in the last decade conducted an enormous military buildup. I am one of those who believe the buildup was wise and necessary. I am also one who believes we should have paid for it in cash. We have not. Instead we have raided the savings of nations around the world to sustain a global presence and domestic comfort. Because we would not pay in cash, we have paid in national wealth instead.

Our debt is colossal and growing, but our dreams are large. So near the end of the 1980's, we have finally begun to assess our future from a broader range of options, and we have begun to ask some sensible questions.

Is it in the best interest of the United States to carry the majority load of spending in all of our alliances? What do we gain from gathering our allies under a defense umbrella that they do so little to hold up? And what do we lose when we target so many of our Federal science and research dollars in the military rather than on commerce?

It is appropriate to ask these questions today because our subject today is defense burdensharing. The questions are appropriate, but they are not easy. So often in this country, those who ask them are suspect either because they imply some doubt about the Nation's vitality or some opposition to a strong national defense.

Neither is the case. But more than 40 years after World War II, we have 325,000 troops in Europe; 35 years after Panmunjon, we still have 45,000 troops in Korea.

With all we spend to defend America and so many others, with all the debt we have built up, we must ask ourselves if it is time for our allies to carry their fair share of the burden. At the end of the World War II, the United States paid for the rebuilding of Europe. We lifted Japan from its devastation. We did it on the notion that free countries able to defend themselves would become active trading partners in expanding international commerce.

That dream has certainly come true. But now the bill has come due, and we are still paying it. The help we gave and the protection we have given have helped Europe and Asia grow back into power; now they are friendly competitors. But while they have taken us to the woodshed in international trade, we are the ones paying for the guards at the woodshed door.

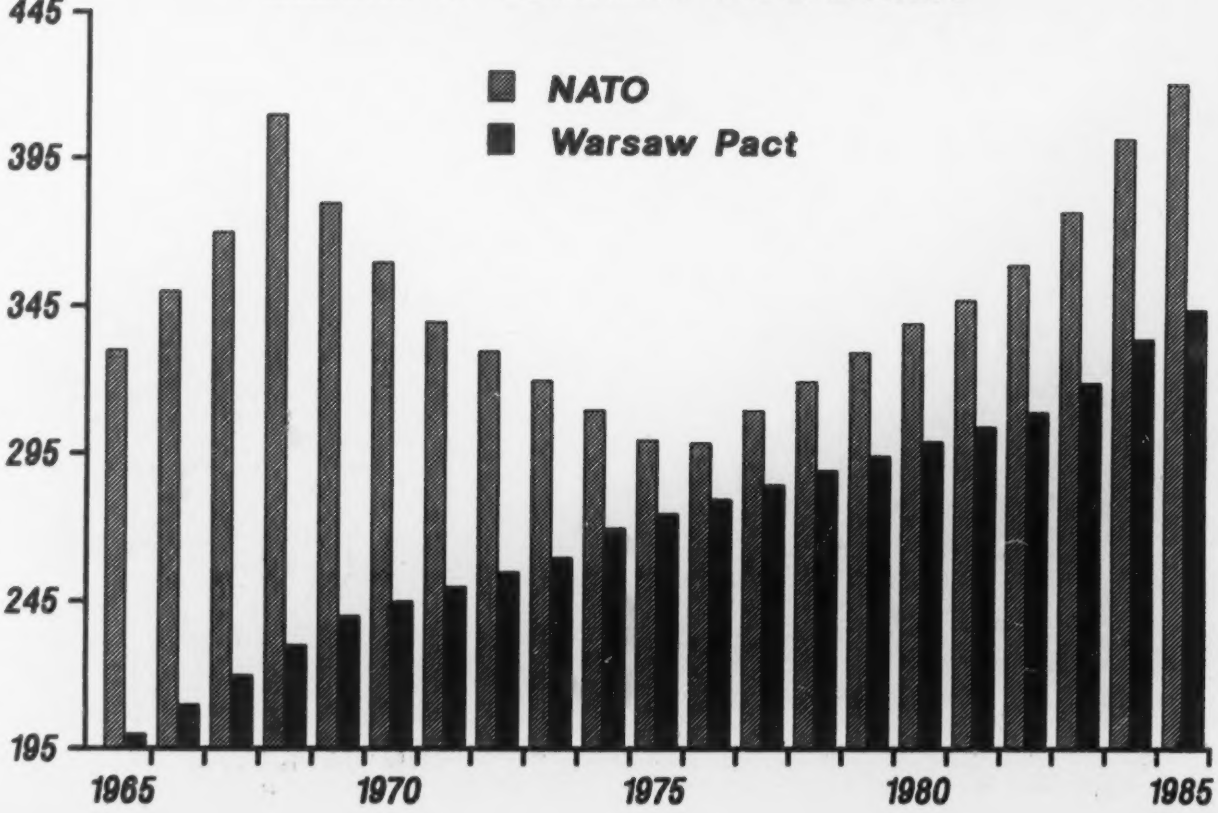
I do not speak from resentment. I simply ask the basic question: Is it time our allies do more to shoulder the cost of security?

That is really the issue before this hearing today. I know the temptation is strong to say the United States can do it all because we have done it before. But the world of 1988 is much different and far more competitive than the broken world of 1945.

We need to ask some new questions. We need to determine how the United States can play its most effective role in world affairs. We need to look at the total size of our burden and better reconcile our military commitments with the resources needed to deal with other national goals.

NATO vs. Warsaw Pact Defense Spending

Billions of Constant 1985 Dollars



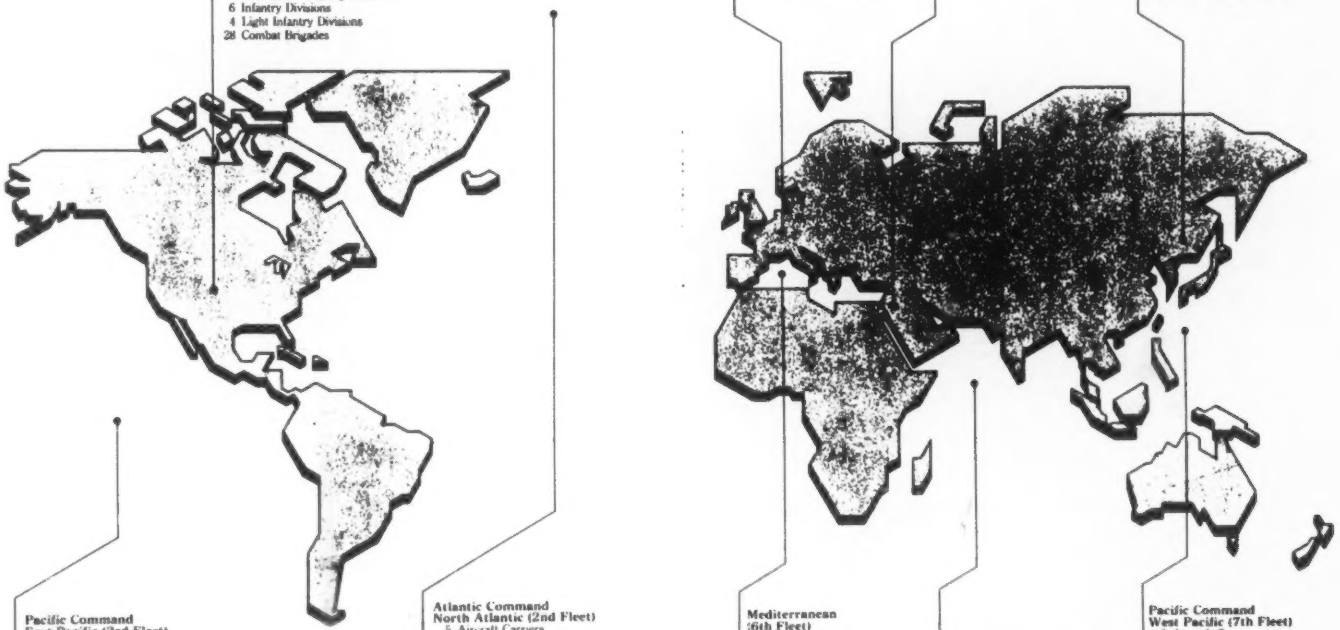
Worldwide U.S. Force Deployments, 1987

U.S./Western Hemisphere
1 Airborne Division
1 Air Assault Division
4 Armored Divisions
6 Mechanized Infantry Divisions
6 Infantry Divisions
4 Light Infantry Divisions
28 Combat Brigades

Western Europe (NATO)
2 Mechanized Divisions
2 Armored Divisions
546 Fighter/Attack Aircraft

Mid-East Force
1 Command Ship
4 Surface Combatants

Northeast Asia/ Western Pacific
2 Infantry Divisions
215 Fighter/Attack Aircraft
1 Marine Amphibious Force



Pacific Command East Pacific (3rd Fleet)
4 Aircraft Carriers
5 Helicopter Carriers
1 Battleship
21 Destroyers
43 Frigates
36 Attack Submarines
20 Amphibious Ships
230 Fighter/Attack Aircraft

Atlantic Command North Atlantic (2nd Fleet)
5 Aircraft Carriers
5 Helicopter Carriers
1 Battleship
9 Cruisers
35 Destroyers
50 Frigates
49 Attack Submarines
18 Amphibious Ships
280 Fighter/Attack Aircraft

Mediterranean (6th Fleet)
2 Aircraft Carriers
1 Helicopter Carrier
3 Cruisers
5 Destroyers
6 Frigates
6 Attack Submarines
4 Amphibious Ships
115 Fighter/Attack Aircraft

Indian Ocean Task Force
1 Carrier Battle Group (Normally provided by Pacific Fleet)

Pacific Command West Pacific (7th Fleet)
2 Aircraft Carriers
1 Helicopter Carrier
5 Cruisers
8 Destroyers
7 Frigates
8 Attack Submarines
5 Amphibious Ships
115 Fighter/Attack Aircraft

It seems to me we are draining our power trying to do too much. Our adversaries are happy to see us try. Our allies have not done as much as they can to help. If, as Mrs. Tuchman says, we are to use our power reasonably, we ask our witnesses' thoughts today on what it means to the future security of the United States and its allies.

Without objection, we will include a statement of Senator Kasten in the record at this point.

[The prepared statement of Senator Kasten follows:]

Statement of Senator Kasten

Thank you, Mr. Chairman. I think both democrats and republicans agree on the general concept of burden sharing. However, I believe that we must carefully examine the underlying economic and national security consequences that burden sharing might entail.

We face many new challenges as we prepare NATO strategy for the 1990's. We must revitalize the coordinated planning that's essential to having our NATO allies participate fully and fairly in future force modernizations.

We must ensure that the alliance's political will continues to be reinforced by U.S. leadership. That includes the Senate leadership as well as the leadership that's going to meet tomorrow. To keep the alliance strong, we have got to have a clear and coordinated position.

All of us have witnessed the wide range of new initiatives that Gorbachev has introduced. I have not found much fault with his rhetoric. However, I would feel a lot better if there were strong actions to go along with it.

Dr. Kennedy, it is my understanding that you feel that we will soon face economic collapse if we continue to overextend ourselves—and that we must make further cutbacks in defense spending.

First of all, I would respectfully disagree with the notion that America's economy is declining. President Reagan's economic policies have resulted in the longest peacetime expansion in U.S. history. Interest rates and inflation have been brought down. More important, we've created 15 million new jobs.

In fact, our overall economic performance under Reagan has been superior to those of all of the major economies in terms of both manufacturing productivity and employment growth.

America's fiscal situation—as troublesome as it is—is nonetheless much better than that of our allies. At this point, I would like to enter into the record the tables comparing the U.S. economic and fiscal performance to that of the OECD economies.

I think these facts undercut the basic premise of your argument. I believe that we must encourage more burden sharing among our allies, not because the U.S. economy is weak and can no longer afford it, but because we desire a more equitable defense commitment on the part of our allies.

We must not use burden sharing as an excuse to make indiscriminate cuts in the defense budget which would jeopardize our national security and diminish our leadership role in the alliance.

If we were to do that, the situation you describe in your book would become a dangerous reality for America.

AVERAGE ANNUAL GROWTH RATES (1981–86)

[In percent]

	Manufacturing productivity	Employment [1]
United States	4.4	1.8
Japan	2.9	1.0
Canada	3.8	1.1
France	3.8	–.2
Germany	3.3	–.3
United Kingdom	4.6	–.8

[1] Using individual countries employment data which may differ in measurement concepts.

Source: International Monetary Fund.

GENERAL GOVERNMENT BUDGET DEFICITS AS PERCENTAGES OF NOMINAL GNP/GDP

	1981	1982	1983	1984	1985	1986	1987 [1]	1988 [1]
United States	1.0	3.5	3.8	2.8	3.3	3.5	2.4	1.8
Japan	3.8	3.6	3.7	2.1	0.8	0.9	.9	.2
Germany	3.7	3.3	2.4	1.9	1.1	1.2	1.5	2.0
France	1.8	2.7	3.1	2.9	2.6	2.9	2.7	2.5
United Kingdom	2.8	2.3	3.6	3.9	2.7	2.9	2.7	2.7
Italy	11.9	12.6	11.7	13.0	14.0	12.6	12.6	12.2
Canada	1.5	5.7	6.6	6.6	6.6	5.4	4.9	4.6

[1] OECD forecasts, except for U.S., which reflect Administration August 1987 forecast updated for 1987 actual deficit.

Source: OECD Economic Outlook, June 1987. Data are on a standardized System of National Accounts basis, except for U.S. and U.K., where national data are used.

FEDERAL DEBT AS SHARE OF GNP

[In percent]

	1973	1986	Change
Austria	10.8	55.9	417.6
Spain	13.8	49.0	255.1
Sweden	22.5	68.8	205.8
Japan	30.9	90.9	194.2
Belgium	54.0	123.2	128.1
Germany	18.6	41.1	121.0
Italy	52.7	88.9	68.7
Netherlands	43.2	72.2	67.1
Canada	45.6	68.8	50.9
France	25.4	36.9	45.3
U.S.	39.9	56.2	40.8
Switzerland	40.3	32.5	7.3
U.K.	71.8	57.7	−19.6
Weighted average	37.5	62.1	65.6

Source: Bank for International Settlements.

Chairman Chiles. Professor Kennedy, we will start off with you. Senator Wirth must leave in a minute. He wanted to hear your testimony.

Senator Wirth. Thank you very much, Mr. Chairman. We have a Banking Committee markup. I would appreciate that.

Senator Domenici. I will tell you something, Mr. Chairman. I do want to make some observations. Why don't we proceed with the professor, and I will make them in between, if you do not mind.

Senator Wirth. Is Ms. Kirkpatrick coming shortly?

OPENING STATEMENT OF SENATOR DOMENICI

Senator Domenici. Mr. Chairman, might I just do this by way of opening remarks? I think the discussion and the issue that you have brought before this committee, Mr. Chairman, is quite an appropriate one.

I have not had the privilege of reading your book, Professor, but I did ask my staff to get some comparisons with reference to America's economic vitality relatively speaking. And, as we go through the afternoon, I will try to ask you a few questions on this subject.

I will tell you what I conclude looking at the economic numbers vis-a-vis all of our allies save Japan. I guess rather than being gloomy, I am rather amazed at how well the American economy has held up in terms of share of the free world's GNP. I am rather amazed at how well our productivity compares with all of our trading partners in the last 15 years save Japan. I am rather amazed at the rates of capital investment in the United States versus our allies. And while I am concerned about the burden of defense, I am also fully aware that much of that was done in response to the Soviet Union's threatening position in the world.

I do not quite know how to gauge success there, except I think if you were in the Soviet Union and free enough to write the same book you wrote here, you would be writing a much gloomier book about them with reference to the failure of their economic system.

Then I look out there and see what has happened in the free world because of the American shield, and I am absolutely amazed at the growth of capacity in the free world on the production of goods and services side resulting from the umbrella, that we have built and our genuine civility in letting our enemies go free and inviting them to become competitors.

I guess I conclude that there are a number of major problems, but I might say that I remain rather convinced that we have gone through a traumatic transition period with some degree of success. We have a trade deficit lingering and a fiscal deficit; but, really, as I looked at the gross capacity of this set of people called Americans and this system we have got, I am rather optimistic that we can make the transition.

Nonetheless, I look with interest at how we can share the defense burden while preserving our freedom. I do not quite know how to do that. I am concerned that we find the Utopia and say we will cut 20 percent and somebody else will fill the gap. And I do not really think that is a workable approach. Something rather sophisticated is going to be required to get some sharing, but I am not sure that we can let up on the defense of the free world, with or without our allies.

As we proceed through, I will ask you about some of these comparative charts.

Thank you very much, Mr. Chairman.

Senator **Wirth**. Mr. Chairman?

Chairman **Chiles**. Yes?

Senator **Wirth**. Just a quick comment. I have read Professor Kennedy's book, and I first discovered Professor Kennedy in the Atlantic Magazine about 18 months ago, Senator Domenici, where he wrote an absolutely brilliant piece on the Soviet economy—on the kinds of problems that are there and that we ought to be aware of as we look at ourselves and look at this relationship.

I think, Mr. Chairman, you are just terrific to have this kind of a hearing which, I guess, makes us look at the world through a bit of a different lens; that maybe the world is changing out there; maybe this is no longer just a bi-polar world, one in which there are significant concentrations of economic and political and military power in Europe, and certainly in various parts of the Pacific Rim growing in Southwest Asia and Brazil.

It does make one wonder as well if perhaps the Japanese are not the main beneficiaries of much of the competition between the U.S. and the U.S.S.R. While the two of us are spending this enormous amount of scarce national treasure, the Japanese are making out very well, indeed. I wonder if this should not suggest to us that maybe we ought to think of redressing the situation in some creative ways, not by withdrawal, as some have suggested Professor Kennedy is talking about—which I do not think he is—but, rather, with emphasizing a greater sharing of the burden, particularly in the Far East. And certainly we ought to get a lot more serious about a more rational expenditure of our defense dollars. We are spending an enormous amount of money with our NATO allies and not spending it very well.

So I think that this hearing makes us think again and think a little more broadly, and I commend you, Mr. Chairman, for having this hearing. Professor Kennedy, I am delighted that you are here, and we look forward to your testimony.

Thank you, Mr. Chairman.

Chairman CHILES. Professor Kennedy.

Mr. KENNEDY. Mr. Chairman, I am in your hands here. I had understood that Mr. Hale was going first with his statistical coverage. I am perfectly happy to proceed.

Senator BOSCHWITZ. Speak into the microphone.

Chairman CHILES. Please pull your mike up a little closer.

STATEMENT OF PROF. PAUL KENNEDY, DILWORTH PROFESSOR OF HISTORY, YALE UNIVERSITY

Professor KENNEDY. First of all, let me say how very much honored I am to be here. I do not want to make this preliminary statement a long one. I wonder if I may refer, Mr. Chairman, to the submission.

Chairman CHILES. Your statement in full will be put in the record.[1]

Professor KENNEDY. Thank you.

It is a somewhat complicated one, asking members to go backwards and forwards. It was composed somewhere over the Rockies and Cascades about 6 days ago, and I added on the appendices to help out.

I think what I would like to do, Mr. Chairman, is to speak very briefly to appendix B. I take it I am here as a historian of long-term trends and rises and falls, and in a sense appendix B is an attempt at a very abstract description of how great and leading powers in the past have risen on the one hand, and then relatively fallen away on the other.

The object discussed throughout the book and throughout this is always relative, Mr. Chairman. Absolute wealth, absolute power, the U.S.A. now has much more than it had in 1945. The relative question, where it is relative to others, where great powers in the world were relative to others, is at the key of the story of the rise and fall.

What I argued in the book and tried in this abstract way to synopsize in appendix B is that, generally speaking, you can trace the way great powers rise and fall from a measure of their relative economic productivity and efficiency. As their shares of the total wealth creation in the world system rise, so they begin to expand outwards to protect their interests. As they expand outwards, they look to protect their interests by a certain diversion of national resources into military protection, military insurance. They acquire new allies; they acquire new areas of interest; they feel they have to protect them.

---

[1] See p. 11.

PERCENT SHARE OF GROSS WORLD PRODUCT

	1960	1970	1980
European Economic Community	26.0	24.7	22.5
United States	25.9	23.0	21.5
Soviet Union	12.5	12.4	11.4
Other Communist countries	6.8	6.2	6.1
Japan	4.5	7.7	9.0
China	3.1	3.4	4.5
Less-developed countries	11.1	12.3	14.8
Other developed countries	10.1	10.3	9.7

Source: Rise and Fall of Great Powers.

This is all well and good as that particular great power's economy is relatively expanding. When, however, it becomes somewhat more of a mature economy, when its growth rates begin to slow down relative to the growth rates of other newer rising economies, it may find itself facing the awkward dilemma of inheriting the enormous array of overseas obligations and commitments which it took on in happier, earlier times but with its relative share of world manufacturing output, of world gross national product, and other indicators of wealth creation somewhat reduced.

So far as I can tell from the historical record, therefore, the dilemma facing U.S. policymakers as it heads towards the early 21st century is one rather similar to the dilemma which has faced earlier number one great powers. They have all in their turn inherited a large array of overseas obligations, which at the time they felt it was perfectly proper to take up. Their relative share of world wealth creation is, however, now much shrunken or considerably shrunken from 30 or 40 or 50 years earlier.

The countries which they were protecting may themselves have grown up economically. There may be a case for burdensharing with allies who are now more vigorous economically. The difficulty is the tradeoff in reducing one's military expenditures overseas and the dangers which may come from that in the face of instability overseas or foreign threats overseas.

In addition to that, all of these powers have had to consider their internal welfare, even though they have been leading powers. All of them have had to trade off, Mr. Chairman, the allocation of resources to domestic consumption or the allocation of resources to military expenditures as a form of national insurance or world interests, or the allocation of expenditures to long-term research and development investment in the future.

If, in addition, they have increased their national debt significantly in peacetime, they have to allocate resources to pay off the national debt.

The great strategical balancing act of leading world powers is, therefore, to be able to trade off these various allocations to make sure that they are in a better position in the future to sustain their overseas obligations or, if they cannot do that, to reduce some of their overseas obligations.

I am a little concerned, Mr. Chairman, of the way in which this message has been simplified. I admit a 700-page book is not an easy thing for people to digest, especially if you are a busy syndicated columnist or whatever, but the way in which it has been rather crudely boiled down to the representation that it is all about the U.S.A. going down the tubes or the U.S.A. becoming the weary titan unable to sustain itself, concerns me.

The book's thesis, even in its final and more contemporary parts, is not like that, Mr. Chairman. It argues that generally we are moving at the economic base and productive base from a bipolar world to a multipolar world by the year 2000 or 2020. It argues that there are two of the five powers who are still bipolar in military terms because they are spending so much more than the others. It argues that they have their complex of problems, and countries like Japan and China have theirs. There are tradeoffs which they have to do. It points out that the Soviet Union is strategically, economically, and structurally in a far worse position than this country to meet the challenges of the early 21st century.

But it does suggest that the U.S.A. is facing an integrated complex of fiscal, diplomatic, foreign policy, and military policy issues, all of which, I think, hang together; which, if not addressed, may leave it in the future in the position of being overextended militarily with all of the absolute territorial obligations it assumed in the 1940's and 1950's, but with a considerably diminished share of world wealth creation and world manufacturing.

I am willing to go into, as far as I can, the various statistical details that Senator Domenici referred to. But I think the overall case—however one slices up the statistics—is that in 1945 to 1950 this country, then possessing almost half of the world's manufacturing output, took upon itself very naturally, and I think very positively, an array of overseas obligations from which it also has been the beneficiary. Senator Domenici's comments are well taken.

The United States after 1945 wanted to reconstruct Europe and Japan and to create a free world order. It has got it. But the economic shifts which have occurred since then do, at least to me, suggest a case for some amount of burdensharing between the U.S.A. and its major allies, as well as internal restructuring.

I am not saying, Mr. Chairman, that the U.S.A. is in a position today facing some sort of catastrophe or apocalypse. But I think that in its due turn it needs a certain amount of a restructuring that a desperate Mr. Gorbachev is attempting to carry out in the Soviet Union.

Thank you, Mr. Chairman.

Chairman CHILES. Thank you, Professor Kennedy.

[The prepared statement of Professor Kennedy follows:]

Written Submission of Professor Paul Kennedy (Yale University) to the Senate Budget Committee, March 1st, 1988.

1. I apologise for the brevity and lack of detail in this submission, but the shortness of time and the crush of duties elsewhere has prevented me from offering a more substantial paper.

2. To compensate a little for this lack of detail, I enclose two documents recently written by myself:

   (i) Appendix A. A reprint of my article in the August 1987 issue of The Atlantic Monthly on "The (Relative) Decline of America".

   (ii) Appendix B. A more theoretical, 12-point paper on why, historically, great nations seem to follow a pattern or relative rise and fall.

   I hope that these do, to some degree, outline my "historical thesis".

3. I trust it will be evident from a reading of both appendices that the concerns I express therein, and the policy options tentatively suggested, are not limited to the economic/financial sphere alone. My chief interest, historically, has been the way in which a nation's productive strength and efficiency has related to its military, Great-Power position; so that my concern about the present position of the USA in the world today also includes the areas of defense and diplomacy, and not economic issues alone. If this submission concentrates upon the economic strand, I hope it will be seen in the context of some larger considerations about how both the prosperity and the power of the United States are best maintained in the long term.

4. There are, it seems to me, a concatenation of problems facing the decision-makers and public of this nation as we head towards the 21st Century:

   (a) The first has been the long-term decline in international competitiveness in the fields of manufacturing, commerce, and technology. Over the past few decades, the economy has not expanded as swiftly as those of a number of other modern, industrialized nations, not to mention the fast-growing NICs. In consequence of this erosion in manufacturing and technological competitiveness, the USA's share of total world GNP, of world manufacturing output, and of many other indices of national efficiency has steadily declined. In addition, its annual trade deficit has risen to worrying levels, its international indebtedness is very high, and its currency is at an all-time low.

   (b) Interacting with this has been the alarming problem of unprecedented federal-government deficits, and the year-on-year increase in the National Debt, which in turn means that a rising proportion of government outlays are needed simply to pay the interest on the debt. The only examples in modern history (that I can think of) of Great Powers so increasing their national debts in peacetime [wartime is different] is France in the 1780s -- i.e., in the years before the Revolution -- and perhaps also Germany and Japan in the 1930s -- before the decision for war. Those are not encouraging precedents.

   In addition, there is the issue of the increasing loss of the USA's economic independence. History is replete with examples of Great Powers who became dependent upon foreign creditors, and suffered badly when that credit was withdrawn: from Emperor Charles V in the 1550s to Britain under Churchill (i.e., after the acceptance of the Lend-Lease conditions), the penalty was clear: you were no longer master in your own house. In this larger, national sense, therefore, I fully concur with Felix Rohatyn's recent observations that, "It is now in Japan's interest to support our economic growth, but we must be able to carry on our business whether or not it is in Japan's interest to finance our deficits" [F. Rohatyn, "Restoring American Independence", The New York Review of Books, February 18th, 1988, p. 10]. This weakness is the more worrying because it exists in an age when high-speed technology can switch billions of dollars out of the currency in the space of minutes. The continuation of declining American manufacturing competitiveness and soaring indebtedness on the one hand, and massive cash flows and a volatile international currency market on the other, is not reassuring.

(c) This set of economic problems would be of concern to a country of very modest diplomatic and strategical ambitions. Instead, the USA is the inheritor of a vast array of military and treaty obligations stretching across the globe. Almost all of those obligations were contracted when the USA's relative economic power was far healthier--indeed, when it alone possessed virtually the only major flourishing economy in the Western World. The obligations still exist, but the USA's share of global productive power is considerably shrunken. This places the military policy of the USA in a "no-win" situation. If spending on the armed forces is boosted (as in the early 1980s), the federal deficit worsens and capital, engineers and scientists are diverted from the non-military to the military sector. If spending is drastically cut without a proportionate cut in overseas obligations [and where would that be?], the services are being asked to over-strain themselves even more. I find it hard to believe that "efficiency measures" in the Pentagon, however instituted, would really close the gap between the nation's many obligations abroad and its capacity to fulfill them.

(d) There are also an array of domestic needs crying for attention--the country's infrastructure, the educational system, the inner cities, the problems of housing and literacy. I am not suggesting that money be thrown around regardless (which is the common charge), but it is difficult to believe that these problems -- which in their turn impact upon the USA's relative efficiency and prosperity -- can be addressed by taking funds away from them.

5. If this seems too gloomy to some readers, we may wish to console ourselves with the thought that the USSR is far less well placed, structurally, economically, and strategically, to meet the challenges of the early 21st Century. Compared with the awkward problems facing the Russian leadership (the nationality problem, Eastern Europe, the changing balances in East Asia, the crisis in agriculture, the breakdown of the health system), the USA possesses enormous strengths. It may also be the case that Mr. Gorbachev's need for perestroika at home rather than adventurism abroad, and the demographic and financial pressures bearing down upon the Soviet armed forces, will lead to a checking in their defense expenditures -- and some corresponding relief to the USA and its allies.

6. But the United States does not enjoy the luxury of competing with the Soviet Union alone. While it maintains its (very expensive) role of being the chief strategical counter-weight to the USSR in the world at large, America also has to compete in both its domestic and foreign markets against the industrial and technological competition posed by faster-growing economies who don't bear such heavy defense burdens. It

has to pay its way in the world. It has to rebuild its credit. It has to preserve and, if possible, strengthen the economic underpinnings of its Great-Power position.

7. All this needs to be placed in the context of what I refer to [in *Appendix B*, point 11] as the four-way "trade-off" in the allocation of national resources: that is, as between (i) consumption, (ii) defense, (iii) debt repayment, and (iv) investment in the future. I believe it is incontestable to say that the balances are *not* right at present -- the sheer size of the Federal deficit each year, and the burgeoning of the National Debt, tells us that.

   But that in turn raises the obvious issue of whether the four-way "trade-off" can be altered, and in what direction, and to what degree? Is there much room for maneuver, or is the country "boxed in" to the present allocation of national resources, despite the problems that is causing? In which of the four areas can anything be done?

8. In respect of (iii) debt-repayment, there is no freedom of maneuver short of repudiation -- but the financial consequences of that action would be disastrous in today's world and altogether more serious [although the historical precedents are analogous] than the debt-repudiations of Habsburg Spain and Bourbon France. Far from having any leeway in this area, the continual annual additions to the National Debt will make debt-repayments rise, both absolutely and relatively, in the foreseeable future.

   In respect of (ii) defense spending, it has been suggested that there are various ways to check, and perhaps even reverse, the increasing shift of national resources into the U.S. armed services which occurred in the first half of the 1980s. These include measures to eliminate the "waste, fraud, and abuse" which, it is claimed, has attended the Pentagon's procurement policies. They include a fairer distribution of "burden sharing" amongst the Allies, some of whom are now richer *per capita* than the USA. They include the consideration of redefining [i.d., withdrawing from] some of the United State's extraordinarily wide-ranging array of strategical obligations across the globe. All of these proposals have their advocates, and perhaps something will be achieved in some, or all, of these areas. Perhaps, too, it may be assisted by a decline in Soviet real arms spending [see 5 above]. But advanced technology is driving the cost of weapons-procurement ever upward, and the need to compete with civilian wage-rates has its own, relentless impact upon the personnel costs of the armed forces. It is therefore difficult to foresee savings being made in this area of a size large enough to make a *significant* impact upon the much-needed redistribution of resources.

   Can, then, we reduce (iv) investment in the future? Under this heading I include monies for improving the school system, for increasing the flow of native-American engineers, scientists and technologists, for basic-science research, for repairing the infrastructure of the country [usually coming from federal and state funds], together with measures to encourage a far higher share of GNP being directed into commercial (not military) R & D. My own very strong feeling is: *absolutely not*. It was the decay in allocating resources in this area which weakened the Great Powers of the past, because they failed to renew the bases for national productivity, efficiency and wealth-creation upon which both their military power and their economic prosperity ultimately depended. The future well-being of the USA is, I feel, going to be affected more than anything else by the resources allocated to (iv).

   What is left, therefore, is the awkward political task of reducing (i) consumption -- either by grasping the nettle of entitlements, or by raising taxes, or by both. This is never a popular option, especially in an election year, but I believe it is necessary. As an historian of the successful and failed Great Powers of the past, I see the USA beginning to imitate previous societies which wanted to have things *now*, and hoped to pay for them in the future. It is the path of continued decline. The alternative is to appeal to the commonsense of the people to accept the logic that we need to pay more now (a) to invest in the future, so that the USA will be economically competitive and strong in the year 2000 or 2020; and (b) to avoid the possible financial disaster that the burgeoning Federal deficit is promising for all of us some way down the line.

Raising taxes and/or reducing entitlements therefore needs to be squarely linked with what will be done with the additional revenues, so that the people can understand the logic of making sacrifices at present so as to reap the benefit later.

APPENDIX B

1. History never stands still. Society is constantly changing, and societies outside are constantly changing. The politician who assumes that things can be deep-frozen in time, the statesman who yearns for a return to an earlier age, is heading for disappointment, if not disaster. "There is nothing more fatal to statecraft," the great British foreign secretary Lord Salisbury observed, "than clinging to the carcasses of past policies."

2. The reason why history never stands still is the inventiveness and growth of mankind. New ideas, new breakthroughs in science, the development of new technologies, changing patterns of demography and settlement, improved forms of communication, affect certain societies at a faster or slower pace than others. The coming of new sources of energy, from coal and oil to nuclear power, advantage one country more than another. In addition to their geographical or natural-resource circumstances, certain societies will possess human constraints - cultural and ethical constraints, ideological and political constraints, the constraints of established lobbies and interest-groups - which will reduce their capacity to take advantage of newer means of manufacture and productive wealth-creation. Other societies will be less constrained.

3. As some societies grow faster than others, so they become wealthier. Wealth is relative, as well as absolute. A wealthier state can buy more goods - more consumer items, more library books, more laboratories, more weapons, more defense forces - than a poorer state. If it continues to renew the sources of its wealth, if it continues to grow, it will enjoy those advantages. If it slows down, if it stagnates, its advantages will disappear.

4. Over time, most economically expanding societies have found that their international commitments have increased - they need to protect their growing trade and investments, to preserve access to new markets and sources of raw material, to help new friends, and ward off fresh enemies or at least deter potential enemies. An increasing diversion of national resources - of talent, of personnel, of energy, of investment - goes into the military. This is quite a natural response - a sort of insurance policy, to secure the country's interests - and if the economy is still growing fast, that diversion of resources is not such a burden. Indeed, arms spending might stimulate under-utilized capacity, as happened to U.S. industry between 1940 and 1944.

5. When nations, or coalitions of nations, have clashed in war, and I refer here chiefly to Great-Power, coalition wars like the Napoleonic war or the two global conflicts of this century, victory has always gone to the side with the most efficient and productive economic base - to the coalition which can keep on producing the tools of war, and whose credit and revenue-raising capacities allow it best to pay for the war. The relationship between front-line military strength and productive economic strength may be a distorted one at the beginning of these great wars - as we know, Hitler's Germany had far larger armed forces than Britain in 1939, or the U.S. in 1941; but at the conclusion of the conflict, military power and economic power stand in much closer relationship to each other.

6. Both in respect of the peacetime changes in technology, trade and growth-rates, and in respect of wartime struggles, there exists a very clear correlation *over time* between a nation's relative economic strength, and relative standing as a Great Power. I say "over time," not only because there may be some short-term exception to that generalization, but also because the economic power and the military power of the state do not rise and fall in parallel. More usually, there is a "lag time." A nation's relative economic expansion comes *before* its growth as a great military power. On the other hand, a nation's relative economic decline comes *before* it loses its position as a great military power.

7. For a Great Power which is in relative economic decline, which is losing its share of world manufacturing, of world GNP, which is less and less capable of paying its way in the world, an awful dilemma arises. It has assumed, in happier times when its economy was much healthier, an array of overseas military and treaty obligations across the globe; it has expanded its armed forces to be the guarantor of peace and stability in this region, and that region, and another region. In a changing and unpredictable world, with new powers rising to the fore, it now seems risky to cut back the spending on armed services which already are over-stretched and over-strained across the globe. Yet it is more difficult to sustain those defense costs on a national economy which now possesses only 18 or 20% of the world's GNP than it was when that economy possessed 45 or 50% of the world's GNP. But if it is difficult to bear the burdens of "imperial overstretch," it is also not very easy to cut those overseas commitments, to withdraw fleets and garrisons, out of the fear that that might lead to instability, to aggression and war. If withdrawals have to occur, they need to be done prudently and diplomatically.

8. As this dilemma becomes more apparent, more and more elements in society will begin to propose ways of dealing with the growing gap between the country's many obligations overseas and its weakening capacity to defend them all. Some will argue for a swift withdrawal to the home base, others will want to be more prudent. There will be a big debate about "burden-sharing" with the Allies, especially with those whose economies have grown faster. There will be a very earnest and bloody debate about which armed services, if cuts are coming, should be most or least affected; demands will be heard for an overall, integrated, long-term strategy - but that is always harder to achieve when resources are declining.

9. In respect of domestic policy priorities, there will be an equally hot debate. Many of the responses will be knee-jerk reactions, blaming everything (or almost everything) on the foreigner, and calling for protectionism - which, far from being a solution to the issue of economic competitiveness, is in most cases a symptom of growing economic *un*-competitiveness. This sort of debate will get very confusing because, while some sectors of the economy are suffering very heavily from foreign competition, others are doing just fine. In a complex, modern economy, it is rarely all black, or all white; all good, or all bad.

10. More sensibly, some commentators will recognize that the root cause of the troubles - the decline in national economic competitiveness - will have to be addressed. They will call, not for superficial measures like protectionism, but for a refurbishing of the national productive base - for a much higher level of investment into *commercial* R & D (not military R & D), for an improvement in the nation's infrastructure, for investment in public education, for the creation of high levels of technical skills in the workforce, for the education of many more engineers and scientists (as opposed to lawyers and dentists).

11. There is, alas, only one problem with that package, of investing in the country's future: it costs money. In every given society, there is a four-way "trade off" in how to allocate national resources: they can be allocated into consumption (which always takes the largest share, simply because we consume most of what we produce); they can be allocated into defense (which may be a small percentage if we have few obligations or a much larger percentage if we have many obligations); they have to be allocated into paying the interest on the National Debt, if the society has been feckless enough to build up a large debt; they can be allocated to productive, long-term investment. Without sustained investment in the future it will be impossible ultimately to bear the burdens of defense or to pay debt interest, or to enjoy high levels of consumption. But where will the money come from? If it is taken from the defense spending of an overstretched Great Power without reducing overseas commitments, the gap between the country's strategical aims and military means will be greater than ever. It cannot come from debt payments. The only alternative left is to take the money from consumption, either by cutting at the entitlements and other services which the state provides, or by raising taxes. Either choice, however, is avoided by politicians because it would be unpopular. Few, if any, politicians in the five-hundred year history of the modern nation-state have thought it profitable to argue to their publics: "We propose reducing your income, and your consumption now, in order that we may all be stronger in the future." I wonder why? Perhaps it is because they suspect that the requirements of most electors are as immediate and short-term as those of most politicians. But if a politician were bold and imaginative enough, it might be worth testing that proposition.

12. Because it is politically unpopular for a mature, established, set-in-its-ways society to divert resources from personal consumption into long-term investment, the relative economic decline continues. Its tendency to produce more and more lawyers, and fewer and fewer engineers, goes unchecked. Its reliance upon ever greater supplies of foreign-made products also increases, and is only temporarily checked by desperate devaluations of the currency, rather than more profound refurbishment of the manufacturing base. This dependency upon foreign products has serious military consequences, whether it be an undue reliance upon imported aero-engines before 1914 or our more contemporary reliance upon imported micro-chips. Because action is not taken with the federal budget, the deficit grows and grows, and the annual interest-payments also grow, crowding out money either for consumption or investment; the nation becomes reliant upon foreign creditors, and its international credit-worthiness becomes precarious. It is no longer an independent Great Power, in the true sense of that term, anymore. Yet because it has also found it difficult to reduce its defense commitments, and thus its defense expenditures, it is further weakening itself in the long term. Without a strong, competitive economic base, its proud military rests upon a house of sand. It is heading for a fall. That happened to Hapsburg Spain, to the France of Louis XIV and of Napoleon, it happened (despite their best efforts to slow it down) to Great Britain a century ago. It is also happening, in many of the elements described above to the Soviet Union today. But is it completely wrong to suggest that there are an uncomfortably large number of signs that it is also occurring in a very real and concrete fashion, to the United States today?

Chairman CHILES. There is a vote underway on the Senate floor, and I think that this might be an opportune time to take a break. We will return shortly.

[Brief recess.]

Chairman CHILES. Mr. Hale.

Mr. HALE. Are you ready to go?

Chairman CHILES. Yes, sir.

STATEMENT OF ROBERT F. HALE, ASSISTANT DIRECTOR FOR NATIONAL SECURITY DIVISION, CONGRESSIONAL BUDGET OFFICE

Mr. HALE. Mr. Chairman and members of the committee, I appreciate the opportunity to testify today regarding defense burden sharing.

I have a statement filled with numbers which I will submit for the record and summarize for you.

Chairman CHILES. It will appear in full in the record.[1]

Mr. HALE. My testimony presents some quantitative indicators that compare defense efforts in the United States with those of our allies. Most of them are taken directly from the March 1987 version of an annual Defense Department report on burden sharing.

Measures in my testimony generally show that relative to its economic strength, the United States is doing more to contribute to the common defense than almost any of its allies. These measures include economic measures, like shares of resources, as well as military measures, such as counts of personnel or of aircraft.

By themselves, these quantitative measures are not an adequate basis for judging what degree of burden sharing would be fair. That is a political judgment that needs to weigh not only the contributions or input of each country, which is what I can measure for you, but also the advantages that each of the countris gets out of the alliance. For this reason I will leave to others the task of judging; will review the indicators here, starting with the economic ones.

Table 1—which is on page 3 [1] of my statement and is also reproduced on this chart—shows the most commonly used measure of a country's defense burden, the percentage of its gross domestic product that it devotes to defense. I might add that for international comparison reasons we use gross domestic products. It is really quite similar in the United States to the gross national product.

In 1986, the United States devoted 6.7 percent of its GDP to defense, compared with an average of 3.3 percent for the non-United States NATO allies and about 1 percent for Japan. Spending varied widely among the NATO allies and Japan, but in 1986, none of the allied countries listed in table 1 devoted more of its GDP to defense than the United States.

I should note that these percentages omit some costs that are borne by some of the European allies. For example, countries with conscription can hold down the wages of conscripts, and therefore their defense costs. Moreover, these percentages do not include the value of land that is used by, say, U.S. forces in Germany. Finally, spending measures exclude contributions by the Federal Republic of Germany to help maintain troops in Berlin.

---

[1] See p. 22.

It does not appear, however, that if you add in or adjust for those costs it would substantially change the conclusions I have just presented. CBO made estimates of German defense spending, taking account of this burden of conscription and these other factors, and it raised German GDP devoted to defense from 3.1 percent to 3.7 percent—still well below our level of 6.7. And Germany is probable the country for which these adjustments are most important, because it has the most foreign troops stationed there.

The patterns in table 1 are altered, but not markedly, if the spending for official development assistance—more commonly called economic assistance—is added to defense spending. As a percent of GDP, the United Stated spends dubstantially less on official development assistance than many of its allies, but the absolute levels are relatively small. So even if you add it in, it does not reverse the finding that the United States devotes more of its resources to national security than the allies.

Nor do results change when another economic measure is used, per capita spending on defense. Table 2 on page 5 [1] of my statement shows how much each U.S. citizen and each of those in other countries devotes to defense. This is shown in more detail in the appendix to my prepared statement.

The United States not only spends more of its resources on defense than its allies today; it has done so for many years. Table 3 on page 6 [1] of my prepared statement shows the portion of GDP devoted to defense since 1955 by the United States and others.

The U.S. percentage declined from 10 percent in 1955 to 5.1 percent in 1980. Then it rose to 6.7 percent in 1986. The average for the non-United States NATO allies has never exceeded 4.5 percent. And compared with Japan, the United States fraction of GDP devoted to defense has sometimes been ten times as high. I might add that the recent downward trend in U.S. defense budgets will narrow the gap only slightly.

Probably the only way to make U.S. and allied defense burdens appear roughly the same in economic terms is to exclude U.S. costs that are thought by some not be be related to NATO defenses. That might include spending for our forces in the Pacific. It might include spending for strategic nuclear weapons.

But there are good arguments, and I have laid them out in my prepared statement, against eliminating what is sometimes called non-NATO spending. And perhaps because of these arguments, DOD always uses total U.S. defense spending in its assessments of burdensharing.

My discussion so far is focused on various economic measures of spending. Another approach to assessing burdensharing considers measures of military capability. Table 4, which is on page 9 [1] of my prepared statement, shows some rough measures for 1985, including defense personnel, ground forces, numbers of tactical aircraft, naval ship tonnage, and numbers of strategic nuclear warheads.

---

[1] See p. 31.

Measured in percentages of totals for all the countries considered in this testimony, the U.S. contribution ranges from 38 percent for defense personnel to 95 percent for strategic nuclear warheads. I think these numbers are up on that chart to your left. The measures show substantial contributions by the non-U.S. NATO allies in several categories, notably defense personnel and ground forces, while contributions by Japan are uniformly low.

The DOD report compares these values with several measures of each country's ability to contribute. Measures of ability to contribute include shares of gross domestic product and total population. U.S. share of military capability roughly matches its ability to contribute in two areas, defense personnel and ground forces, and exceeds those measures in three others: tactical aircraft, naval ship tonnage, and strategic nuclear warheads.

Moreover, these measures may sometimes understate the U.S. contributions, because in many cases——

Chairman CHILES. Where are you speaking from now?

Mr. HALE. I am on page 10 now, I am sorry. These measures may understate the U.S contribution, because in many cases our weapons are more modern than those of our allies.

In sum, Mr. Chairman, the quantitative measures in my testimony show that while allied contributions are sometimes substantial, the United States devotes a larger share of its resources to the common defense than any of the allies, and, by several measures, does more than its share in key categories of military capability.

There are, however, some important limitations in using these quantitative measures to judge the fairness of burdensharing. Some factors simply cannot be quantified. For example, the Federal Republic of Germany has a substantially greater proportion of foreign military personnel within its borders than does the United States, with resulting problems of noise and environmental encroachment. Nor can quantitative measures capture the political costs of persuading a country's electorate to support defense spending.

A 1986 Gallup poll that I find very interesting shows that, compared with U.S. citizens, a smaller proportion of citizens in allied countries feel there is a substantial chance of a major war within the next 10 years. That may make it more difficult to build a consensus in those countries for high defense spending.

I think the most important limitation on these results is that the quantitative indicators measure the contribution, the input if you will, to defense. They don't measure the benefits obtained. Perhaps in part because of our various alliances, the United States and its allies have enjoyed 40 years without an armed confrontation with our principal adversary. No one can measure that benefit, but it's obviously substantial. Nor can anyone measure how much the United States would decide to spend on its own defense in the absence of these various alliances.

I think that quantitative measures are a good place for you to start in assessing burdensharing, because they do suggest how much each country is contributing to common defense. But they are not a good place to stop. You must also assess the benefits of the alliances, which I know is one of the goals that you have today.

That concludes my prepared statement, and whenever it's appropriate, I would be glad to answer any questions.

Chairman CHILES. Thank you very much, Mr. Hale.

[The prepared statement of Mr. Hale follows:]

Statement of
Robert F. Hale
Assistant Director
for
National Security Division
Congressional Budget Office

before the
Committee on the Budget
United States Senate

March 1, 1988

Mr. Chairman, and members of the Committee, I appreciate the opportunity to testify today regarding defense burdensharing. My testimony presents quantitative indicators that compare the defense efforts of the United States with those of our allies. Many of these indicators are taken from the March 1987 version of an annual Department of Defense (DoD) publication, titled Report on Allied Contributions to the Common Defense.

Measures in my testimony generally show that, relative to its economic strength, the United States is doing more to contribute to the common defense than almost any of its allies. While the allies vary widely in economic measures of burdensharing, none of them is devoting a larger portion of its resources to defense than the United States. Measures of military capability--such as counts of personnel or of aircraft--sometimes show substantial allied contributions. But, again, most of these measures show the United States contributing more in military capability than its share of total allied resources.

By themselves, these quantitative measures are not an adequate basis for judging what degree of burdensharing would be fair. That judgment is a political one that must weigh not only the contributions to allied defense, which is what I can measure for you, but also the benefits realized by the United States and its allies, which cannot be reliably quantified. For this reason, I will leave to others the task of judging. Instead, I will review and explain the available quantitative indicators, beginning with economic measures.

ECONOMIC MEASURES

Table 1 shows the most commonly used measure of a country's defense burden--the percentage of gross domestic product (GDP) devoted to defense. In 1986, the United States devoted 6.7 percent of its GDP to defense compared with an average of 3.3 percent for our NATO allies and about 1 percent for Japan. (Because of delays in compiling foreign data, 1986 is the latest year for which data are available.)

Spending varied widely among the NATO allies and Japan, but in 1986 none of the allied countries listed in Table 1 devoted more of its GDP to defense than the United States. The second column of Table 1 shows an index of their share of GDP relative to U.S. percentages. An index value of 100 indicates that a country spends as much as the United States in relation to GDP; smaller values indicate lesser portions of resources devoted to defense. Index values range from 14 for Luxembourg to 90 for Greece. For all of the non-U.S. NATO allies together, the index averages 49, indicating that their ratio of defense spending to GDP is about one-half as large as the U.S. ratio.

I should note that these percentages of GDP omit costs borne by many European allies. For example, countries with conscription can limit the wages of their conscripts and hence their defense costs. If recruits in those countries were paid market wages--as they are in the United States with its volunteer military--then NATO defense spending would be higher. Nor do the percentages of GDP that I am using include the value of land and

TABLE 1. 1986 DEFENSE EXPENDITURES AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT (GDP)

	Percent of GDP	Index of Effort (U.S. = 100)
United States	6.7	100
Non-U.S. NATO Average	3.3	49
Belgium	3.0	44
Canada	2.2	33
Denmark	2.0	30
France	3.9	58
Germany	3.1	46
Greece	6.1	90
Italy	2.2	33
Luxembourg	0.9	14
Netherlands	3.1	46
Norway	3.1	46
Portugal	3.2	48
Spain a/	2.0	29
Turkey	4.8	71
United Kingdom	5.0	74
Japan a/	1.0	15

SOURCES: Congressional Budget Office computations using data from "Financial and Economic Data Related to NATO Defense," NATO Press Service, December 1987 (for defense expenditures); and data for gross domestic product from International Monetary Fund, International Financial Statistics, (January 1988).

NOTE: Defense expenditures are measured for the fiscal year that most closely overlaps calendar year 1986; GDP data are for calendar year 1986. The non-U.S. NATO average is weighted by each country's GDP.

a. Defense expenditures for Spain and Japan use the national, not NATO, definition, as reported in International Institute for Strategic Studies, The Military Balance 1987-88 (London: IISS, 1987).

facilities provided free by host countries to U.S. forces stationed overseas. Finally, spending measures exclude contributions by the Federal Republic of Germany to help maintain troops in Berlin. These particular costs can be approximated.

It does not appear, however, that these omitted costs would fundamentally alter the results shown in Table 1. The Congressional Budget Office (CBO) estimated the additions to German defense spending needed to take account of the burden of conscription, the value of land used by foreign troops, and the support of the Berlin garrison. Those additions increased the portion of German GDP devoted to defense from 3.1 percent to 3.7 percent, still well below the U.S. level of 6.7 percent. CBO did not have the data to perform these calculations for all U.S. allies. But this adjustment is likely to be most important for Germany because of the number of foreign forces stationed in that country.

The patterns in Table 1 are altered, but not markedly, if spending for official development assistance (ODA) is added to defense spending. ODA spending--more generally called economic assistance--is not used to assist a country's military forces directly. But it may indirectly aid a country's defenses by allowing it to spend more of its own resources on defense or by helping its economy grow. The United States spends substantially less on official development assistance, as a percentage of its GDP, than many of our allies (see Table A-1 in the appendix to my testimony). But ODA spending is small relative to defense spending. Therefore, adding it to defense spending does not reverse the finding that the United States devotes more to national security efforts than its allies.

Nor do results change when another economic measure is employed--per capita spending on defense. Table 2 shows that, when all 1986 defense spending is converted to U.S. dollars using 1986 exchange rates, the United States spent about $1,155 per person on defense compared with an average of $318 among non-U.S. NATO allies and $163 for Japan.

The gap in per capita defense spending narrows, but is not eliminated, if 1987 exchange rates are used rather than 1986 rates. By that measure, the United States spends about $1,155 per person on defense compared with an average of $362 among non-U.S. NATO allies and $192 for Japan. The importance of this gap may be further lessened for some countries if one

TABLE 2. PER CAPITA DEFENSE SPENDING, 1986 (In U.S. dollars)

	1986 Exchange Rates	1987 Exchange Rates
United States	1,155	1,155
Non-U.S. NATO Average a/	318	362
Japan	163	192

SOURCE: Congressional Budget Office, based on NATO and IISS data for defense expenditures and International Monetary Fund data for exchange rates and population estimates.

a. Table A-2 shows data by country.

believes that richer nations should spend proportionally more on defense. Average GDP per person--a common measure of "richness"--in the United States is about twice that among non-U.S. NATO allies.

The United States not only spends more of its resources on defense than its allies today; it has done so for many years. Table 3 shows the portion of GDP devoted to defense since 1955 by the United States and others. The United States percentage declined from 10 percent in 1955 to 5.1 percent in 1980, then rose to 6.7 percent in 1986. The average for non-U.S. NATO allies never exceeded 4.5 percent. Compared with Japan, the U.S. fraction of GDP devoted to defense has been up to 10 times larger over the same period. The recent downward trend in U.S. defense budgets will narrow the gap only slightly.

TABLE 3. PERCENTAGE OF GROSS DOMESTIC PRODUCT DEVOTED TO DEFENSE

	1955	1960	1965	1970	1975	1980	1986
United States	10.0	8.9	7.4	7.7	6.0	5.1	6.7
Non-U.S. NATO Average a/	4.5	4.1	3.8	3.1	3.2	3.0	3.3
Japan	1.0	1.1	0.9	0.8	0.9	0.9	1.0

SOURCE: Congressional Budget Office, based on data from NATO, the IISS, and the International Monetary Fund.

a. Table A-3 shows data by country.

Probably the only way to make the U.S. and allied defense burdens appear roughly the same is to exclude costs that are thought by some to be unrelated to NATO defenses. There is no good way to measure the proportion of the U.S. defense budget spent on the NATO alliance. With some misgivings, the Department of Defense has made rough estimates suggesting that close to 40 percent of the U.S. defense budget is spent on forces not directly committed to NATO. Eliminating non-NATO spending from the U.S. and NATO totals would alter the comparisons substantially, suggesting that the United States and its allies spend roughly the same share of their resources on direct NATO costs.

But there are good arguments against eliminating non-NATO spending. U.S. forces not directly committed to NATO play an important part in overall alliance defenses. Strategic nuclear forces, though excluded from direct NATO costs in DoD calculations, play a key role in deterring an attack on NATO. Forces stationed in or designated for the Pacific and Persian Gulf regions protect vital NATO interests, such as oil supplies in the Persian Gulf. Moreover, the existence of these forces may force potential adversaries to devote some of their defense budgets to non-NATO areas, rather than focusing solely on the European theater. Perhaps for these reasons, DoD always uses total U.S. defense spending in its assessment of burdensharing.

MILITARY MEASURES

My discussion so far has focused on various spending measures. Another approach to assessing burdensharing considers measures of military capability. Table 4 shows some rough measures for 1985, including defense personnel (defined as total numbers of active-duty personnel, reserves, and civilian personnel), ground forces (measured by division equivalent firepower scores that reflect both numbers and quality of equipment), numbers of tactical aircraft (naval and air forces combined), naval ship tonnage (excluding strategic submarines), and numbers of strategic nuclear warheads. Most of these measures come directly from the 1987 DoD report on allied contributions, though CBO has made additions and amendments to provide a more complete picture. Measured in percentages of totals for all the countries considered in this testimony, the U.S. contribution ranges from 38 percent for defense personnel to 95 percent for strategic nuclear warheads. The measures show substantial contributions by the non-U.S. NATO allies in several categories, notably defense personnel and ground forces. Contributions by Japan are uniformly low.

The DoD report compares these shares with several measures of each country's ability to contribute. Measures of ability to contribute include 1985 shares of gross domestic product and total population. The United States, for example, had 32 percent of the total population of all the allies considered in this testimony and 39 percent of the total GDP (converted using 1987 exchange rates). The U.S. share of military capability roughly

TABLE 4. 1985 INDICATORS OF MILITARY CONTRIBUTION AND ABILITY TO CONTRIBUTE (In percents of total)

	United States	Non-U.S. NATO	Japan
	Military Indicators		
Total Defense Personnel a/	38	59	2
Ground Forces	39	57	4
Tactical Combat Aircraft b/	60	36	4
Naval Ship Tonnage	64	33	3
Strategic Nuclear Warheads c/	95	5	0
	Ability to Contribute		
Share of GDP d/	39	40	21
Share of Population	32	52	16

SOURCES: Except as noted, Department of Defense, Report on Allied Contributions to the Common Defense.

a. Active-duty military, civilian personnel, and committed reserves.

b. Based on data presented in the DoD report, adjusted to include naval tactical aircraft.

c. Computed by the Congressional Budget Office, based on data in International Institute of Strategic Studies, The Military Balance, 1985-1986.

d. Congressional Budget Office, based on 1987 exchange rates.

matches measures of its ability to contribute in two areas (defense personnel and ground forces) and exceeds those measures in three others (tactical aircraft, naval ship tonnage, and strategic nuclear warheads).

Moreover, these measures may understate the U.S. contribution. Most of the measures simply count weapons. Often, however, the U.S. weapons are more modern. For example, the DoD report shows that 45 percent of U.S. tactical aircraft in its Air Force were classed as new-generation forces while only 25 percent of the NATO countries' air force aircraft were in that category.

CONCLUSIONS

Mr. Chairman, the quantitative measures in my testimony show that, while allied contributions are sometimes substantial, the United States devotes a larger share of its resources to the common defense than any of the allies and, by several measures, does more than its share in key categories of military capability.

There are, however, important limitations in using these quantitative measures to judge the fairness of burdensharing. Some factors cannot be quantified. For example, the Federal Republic of Germany has a substantially greater concentration of foreign military personnel within its borders than does the United States, with resulting problems of noise and environmental encroachment. Nor can quantitative measures capture the political costs of persuading a country's electorate to support defense spending. A 1986 Gallup poll shows that, compared with U.S. citizens, a smaller proportion of citizens in allied countries feel there is a substantial chance of a major war. Thus, it may be more difficult to build a consensus in allied countries for high defense spending.

More importantly, the quantitative indicators in my testimony only measure the contribution of various countries to defense. Those contributions must be judged against the benefits obtained. Perhaps in part because of our various alliances, the United States and its allies have enjoyed 40 years without an armed confrontation with our principal adversary. No one can measure the benefit of avoiding confrontation, though it is obviously substantial. Nor can anyone measure how much the United States would need to devote to its own defense in the absence of these alliances.

Quantitative measures, then, are a good place to start in assessing burdensharing, because they do suggest how much each country is contributing. But they are not a good place to stop. You must also assess the benefits of the alliances, which I know is one of your goals in this hearing.

APPENDIX

TABLE A-1. DEFENSE AND ECONOMIC ASSISTANCE COMBINED, IN PERCENTAGES OF GROSS DOMESTIC PRODUCT, 1986

Country	Defense Expenditures	Economic Assistance	Combined Expenditures	Index of Effort (U.S. = 100)
United States	6.7	0.2	7.0	100
NATO Allies				
Belgium	3.0	0.5	3.4	49
Canada	2.2	0.5	2.7	39
Denmark	2.0	0.9	2.8	41
France	3.9	0.7	4.6	66
Germany	3.1	0.4	3.5	51
Greece	6.1	--	6.1	87
Italy	2.2	0.4	2.6	38
Luxembourg	0.9	--	0.9	14
Netherlands	3.1	1.0	4.1	59
Norway	3.1	1.1	4.3	61
Portugal	3.2	--	3.2	46
Spain a/	2.0	--	2.0	28
Turkey	4.8	--	4.8	69
United Kingdom	5.0	0.3	5.3	76
Non-U.S. NATO Weighted Avg. b/	3.3	0.5	3.7	54
Japan a/	1.0	0.3	1.3	19

SOURCES: Congressional Budget Office computations using data from "Financial and Economic Data Related to NATO Defense," NATO Press Service, December 1987 (for defense expenditures); and data for gross domestic product from International Monetary Fund, International Financial Statistics (January 1988); and Organization for Economic Cooperation and Development, Development Assistance (December 1987).

NOTE: Detail may not add to totals because of rounding.

a. Defense expenditures for Spain and Japan use the national, not NATO, definition, as reported in International Institute for Strategic Studies, The Military Balance 1987-88 (London: IISS, 1987).

b. Using 1986 gross domestic product shares.

TABLE A-2. PER CAPITA DEFENSE EXPENDITURES, 1986
(In U.S. dollars)

Country	Per Capita Defense Expenditures	Index of Effort (U.S. = 100)
United States	1,155	100
NATO Allies		
Belgium	346	30
Canada	308	27
Denmark	322	28
France	511	44
Germany	453	39
Greece	232	20
Italy	235	20
Luxembourg	145	13
Netherlands	365	32
Norway	519	45
Portugal	90	8
Spain a/	113	10
Turkey	53	5
United Kingdom	488	42
Non-U.S. NATO Weighted Average	318	27
Japan a/	163	14

SOURCES: Congressional Budget Office computations using data from "Financial and Economic Data Related to NATO Defense," NATO Press Service, December 1987 (for defense expenditures); and data for gross domestic product and exchange rates from International Monetary Fund, International Financial Statistics (January 1988).

a. Defense expenditures for Spain and Japan use the national, not NATO, definition, as reported in International Institute for Strategic Studies, The Military Balance 1987-88 (London: IISS, 1987).

TABLE A-3. DEFENSE SPENDING IN PERCENTAGES OF GROSS DOMESTIC PRODUCT
(Based on data in national currencies)

Country	1950	1955	1960	1965	1970	1975	1980
United States	4.7	10.0	8.9	7.4	7.7	6.0	5.1
NATO Allies							
Belgium	2.6	4.0	3.6	3.2	2.9	3.1	3.3
Canada	2.6	6.3	4.2	2.9	2.3	2.0	1.9
Denmark	1.7	3.2	2.7	2.8	2.5	2.5	2.4
France	4.7	6.4	6.5	5.2	4.2	3.8	4.0
Germany	n.a.	4.1	4.0	4.3	3.3	3.7	3.3
Greece	5.0	5.1	4.9	3.5	4.8	6.8	5.7
Italy	3.3	3.7	3.1	3.1	2.5	2.5	2.4
Luxembourg	0.9	3.2	1.0	1.4	0.7	0.9	1.0
Netherlands	3.6	5.7	4.1	4.0	3.4	3.2	3.1
Norway	2.5	3.9	2.9	3.8	3.5	3.2	2.9
Portugal	3.5	4.2	4.2	6.2	7.1	5.3	3.5
Turkey	5.7	5.6	5.1	5.0	4.4	6.3	4.7
United Kingdom	6.0	8.1	6.4	5.8	5.1	5.2	5.0
Non-U.S. NATO Weighted Avg. a/	n.a.	4.5	4.1	3.8	3.1	3.2	3.0
Japan b/	n.a.	1.0	1.1	0.9	0.8	0.9	0.9

SOURCES: Congressional Budget Office, based on NATO definition of defense expenditures and GDP data from the International Monetary Fund.

NOTE: n.a. = not available.

a. Using 1986 national GDP shares as weights. Spain was not included, because historical data consistent with that of the other NATO nations were lacking.

b. Defense expenditures for Japan use the national, not NATO, definition, as reported in International Institute for Strategic Studies, The Military Balance 1987-88 (London: IISS, 1987).

Chairman CHILES. I was hoping that the Ambassador would be here by now so that we could take her statement.

Senator Hollings.

Senator HOLLINGS. Dr. Kennedy, you're a brilliant historian. And I understand what Mr. Hale said just a minute ago about political will. And we face a political decision regarding our commitment of troops. It's nice for us to sit around as budgeteers and say we're doing a greater share and so we're not going to do anymore, and we can cut the budget, and therefore, put more over into the domestic side, let's say.

But that's not necessarily going to work out. And I'm not going to argue that point. I just wonder how, with your brilliance, you get into the litany about protectionism. It's a given.

The comparative advantage, economically, in this day and age, is government. And we don't bash the Japanese for it. Let's take them or Europe as examples.

The Japanese revived after World War II with our assistance, but their government paid for the research. We did the same thing in agriculture. We developed agriculture by putting in land grant colleges, regional research, experimental stations, the price supports and so on.

And if you and I wanted to plant a victory garden, all we'd have to do is call up a county agent in the District of Columbia, and he'd come around tomorrow and give you a soil test, and that's worked.

But we have stopped government training and support of that kind with respect to business, and wisely so, as long as we could hold on to that competitive free enterprise system.

But now it's government-to-government enterprise. And scholars like yourself in Japan, they'll pay for your research. It's all directed under MITI.

Then when I get the capital to produce a product, I have a nine to one advantage at capitalization, where I put my particular commodity out on the market. Rather than antitrust, they have got pro-trust. They control, protect, totally, their domestic market.

And once I develop a quality product, then they put it out on a protected targeted basis, and they have taken over the world markets.

When we make it to their economic interest, that's when they'll finally open their markets. We have to be like Roosevelt. You are a historian. You know that in order to keep the banks open, he closed the doors. In order to save the farms, he plowed under the crops.

In order to remove a barrier, we've got to raise one and then, later, remove them both. We all believe in free trade, but we all live in the real world.

I am reading your litany about protectionism, protectionism. I'm going out of business. I'm losing my standard of living. I'm losing my capacity to continue as a world power, to produce steel and glass and rubber.

We just had an objection 5 minutes ago that the World Bank is now going to finance $400 million for steel down in Mexico, and we're not financing any steel in the United States of America. They're landing Brazilian steel in front of my home in Charleston, SC.

But where do you get this protectionism, and the idea that there is some kind of economic comparative advantage about free trade and no barriers, when the whole world is just rampant with protectionism.

Our rivals use inspection practices, subsidies, protective measures, and it's dynamic. It's worked for Korea. And that's the competition, and you and I can't change it. I'm losing industry. I used to bring the industry from up in Massachusetts down to South Carolina.

Now, in order to meet that international economy and competition, they're moving down to Mexico, because you can produce anything anywhere.

So where do you folks come up with this protectionism nonsense? If we don't use our government, we're gone. We're gone.

I'm opposed to the Gephardt amendment. I don't think it's an arithmetic problem. But we don't even enforce countervailing duties, trigger price mechanisms, and all the rest of it.

I admire you, and I'm fascinated with your writings. That's why I came to this hearing. I had to cancel appointments, and people will get angry. But I want to learn from you.

Professor KENNEDY. Well, thank you. I would say historically there never has been a total world free trade system where everybody was equal, and I think we know that.

Senator HOLLINGS. Amen. The first bill that passed on July 4, 1789, was a 50-percent tariff on 70 articles by Jefferson, Madison and Hamilton. Yes, sir, that's how we started this country, with protectionism.

Professor KENNEDY. It's a device which various governments use in their own good time to protect their interests. Other governments and their political culture think that protectionism is not so good for them.

Usually, though, historically, it has been the country that is at the top of the tree economically and in terms of comparative productive advantage, like Great Britain in the 1840's, or the United States after 1945, which has said, let's reduce all of these protective barriers; let's go for free trade; let's open up the world.

Senator HOLLINGS. That was a good option at that time. I'm talking about 1988. Where do I go now?

Professor KENNEDY. So let me go on to it. In a changed circumstance, in a circumstance in which other countries have revived their competitiveness, or have had, in this case, had the United States helping to revive their competitiveness through Marshall Plan onwards, and in another political culture, such as Japan's or many of the West European states, where the role of the state has never been, as it were, regarded so low, or held at a certain distance from the individual, as in the more laissez faire culture in this country, in those societies it has seemed fairly natural to go and get a whole array of supports from the state to enhance your economic power, your economic competitiveness overseas.

So the USA's dilemma, Senator, I see historically as being very similar to that faced by Great Britain around the turn of the century. It also was facing competition from rising foreign economies, using the state to buttress their economic and export expansion, giving an array of supports to their expansion.

Great Britain did not want to move from free trade. On the other hand, these other countries, because of governmental support, were not indulging in absolute free trade. The USA, I suspect, is in a similar position.

What I am worried about in terms of protectionism, if it means simply bringing in tariffs to protect something manufactured in this country, is that the historical record suggests that when an industry hides behind protective barriers, that far from competing with the outside world, far from keeping up with the new advances, it tends to rely on the protective barriers as a crutch.

And therefore, I think my argument would be that protectionism, one needs to be careful of, because it is often a sign of a wish to retreat out of global technological competition into a safe domestic market, rather than to meet the competition head on.

Meeting it head on is admittedly difficult when other governments give more support to their industry than we do. But I'm not sure that protective tariffs, except perhaps in some strategic materials and strategic products areas, is such a good thing in the long term.

Senator **Hollings**. Well, I will yhield, but the facts are otherwise. You can produce anything anywhere. So the telephones, for example, that they used to manufacture down in my home State are now manufactured in Singapore.

I just can go down the list. And other governments hide behind that shibboleth of protectionism.

I mean, we literally are losing. Textiles are gone; steel is going. And you can go right on down the list of our lost industrial production.

And then when I go to Harvard. Les Thurow says we ought to be happy. Reich says "small is beautiful", and the other fellow says, service economy, service economy. That's what they told the British when they were going out of business. At the end of the world war, they were going to be a nation of brains rather than brawn; have a service economy.

And now you folks are coming down to Washington and telling us that we ought to be happy with what is happening.

Professor **Kennedy**. Mr. Senator, I don't think my message is entirely that we ought to be happy. But I do think in response to your cluster of comments that a consideration of burdensharing between the allies could well take on board the economic elements of relationships between the allies and not simply the military measures, as laid out in some of these tables.

There is a tradeoff between economic advantage and economic burdensharing, as well as military advantage and military burdensharing. I wouldn't deny that for a moment.

Chairman **Chiles**. Ambassador Kirkpatrick has arrived, and we'll be glad to take your statement. We are delighted to have you come before the committee.

STATEMENT OF HON. JEANE J. KIRKPATRICK, LEAVEY PROFESSOR OF GOVERNMENT, GEORGETOWN UNIVERSITY

Ambassador **Kirkpatrick**. Thank you very much, Senator.

I should like to thank you for inviting me. And I am very pleased to take part in this discussion, whose importance I think is manifest.

Academic that I am, I should like to begin with a few comments on Professor Kennedy's analysis, which interested me a great deal. I read his book with great interest.

It is not often that a sweeping consideration of historical change catches the attention of American policymakers. But then there aren't many books which link a sweeping overview of history to a current policy question, as this one does.

This book, as I understand it, brings, or seems to bring, the weight of human experience to consideration of appropriate levels of defense spending and various types of economic protectionism.

That I think is the reason why the subcommittee has invited us to appear today.

I might note that I think Professor Kennedy is careful in the statement of his argument and his inferences; much more careful, of course, that some of the people who comment on his argument and his inferences.

But there's always a danger that when a serious book is swept into public attention——

Chairman CHILES. Ambassador, would you pull your mike up just a little bit more?

Ambassador KIRKPATRICK. It is distorted in the process. The questions that Professor Kennedy poses, with which we are all concerned these days in some form, are, Who is number one? Who is in decline? What are the sources of power? What is the shape of the world to come?

Some of Professor Kennedy's answers are quite clear. The United States has been number one, and is in relative decline. The American share of world power has been declining relatively faster than the Soviet Union in the last few decades, and than some other countries. But our absolute strength is still much larger than that of the Soviet Union.

The United States, he says, is still, at present, in a class of its own, economically, and perhaps even militarily.

Nonetheless, "it cannot avoid confronting the two great tests that challenge the longevity of every major power that occupies the number one position in world affairs"—this is Professor Kennedy I'm quoting here.

What are the two great tests? "Whether it can preserve a reasonable balance between the nation's perceived defense requirements and the means it possesses to maintain those commitments.

"Whether it can preserve the tecnological and economic bases of its power from relative erosion in the face of ever shifting patterns of global production."

The American decline, he reminds us again and again, is not absolute, but relative. The only serious threat to the real interests of the United States, he says, and I wholly agree, can come from a failure to sensibly adjust to a newer world order.

That adjustment, in his view, depends on "bringing into balance the Nation's commitments and the Nation's power." That's Walter Lippman's phrase, as Kennedy notes. And the problem, he suggests, finally depends on making wise choices between guns and butter and investment.

Now, I see various problems with this analysis. And I'd like to summarize them briefly, and explain why I think this analysis has limited relevance to the policy choices confronting the American people and the Senate and this committee today.

First, I would note that though Professor Kennedy promises us that he will eschew "crude economic determinism"—that's his phrase—he believes that "the crucial influence of productive economic forces in determining the decline and fall of nations is paramount.

"To be a great power, by definition, a state capable of holding its own against any other nation, demands a flourishing economic base," he tells us.

To be a great power, you need to be both rich and strong.

Now of course this is both true, and not true, as Professor Kennedy also knows. The Soviet Union is the clearest possible argument against the proposition that a great power must have a great industrial base, or that an economic substructure must be able to support a great military establishment, or that preeminent military power depends on technological preeminence.

The Soviet Union is the clearest possible refutation of the notion that defense expenditures must be kept in harmony with economic growth, or economic strength, in order to produce economic growth.

Everybody knows that a very large share of the Soviet GNP is devoted to defense, to military expenditures; that this has been the case since Stalin; and as a matter of fact, it has been the case during the entire period that the Soviet Union became a great power and has maintained itself as a great power.

Now, Professor Kennedy understands this, and he says the Soviet Union faces awkward choices and an unprecedented economic crunch. I believe that, too, let me say. And that the Soviet Union's prospects for escaping from its contradictions are not good.

But since Professor Kennedy's analysis of Soviet power ignores the way it came to be so strong, I don't think we can put much confidence in his analysis of why it must decline.

I emphasize the case of the Soviet Union, because I think it is the key case. It is, better than any other example in the modern world, the proof that there is no necessary correlation between the level of military expenditures and the level of economic growth. It's the clearest possible example that the power of nations does not really depend on a calibration of military and economic strength.

The fact is that the Soviet Union's power has been "overextended" since the time the Bolshevik's decided to rule by force the great multiethnic, multinational empire that Lenin himself had called "a great prisonhouse of peoples."

What the Soviet experience demonstrates in our time, really quite conclusively, is that there is no reliable correlation between economic power and military power except at the extremes, and no reliable correlation between percent of GNP spent on defense and the level of economic growth. Now, we can also draw proof of that from the American experience as well.

"*The London Times*" noted a couple of years ago that the Soviet Union is a Third World country with First World weapons.

We might also note that Japan is a First World country with military strength less than that of China. And of course that the European Community's economic strength far exceeds its relative military strength.

The fact is that the Bolsheviks rose to power because of the political skills they possessed. And those political skills escape any type of determinist analysis. They escape Professor Kennedy's analysis as completely as they escape Karl Marx's analysis.

In putting too much emphasis on purely economic factors, there's too little attention paid to such human dimensions as skill and experience (though Professor Kennedy mentions those repeatedly), and such moral factors as human purpose and human nature, such political factors as policy, including economic and defense policies.

I think the basic problem with trying to ask "Who is in decline?" "Who is number one?" and using a combined index of military and economic strength, is that these factors do not really belong together.

The new industrial and trading nations constitute no military threat, and, of course, the Soviet Union constitutes no economic threat. And finally, you know, we cannot deal with the potential military threat of the Soviet Union by cutting defense expenditures, and competing more effectively with Japan and the new industrial nations, any more than they can deal with their military problems by competing more effectively.

There is competition and competition, and strength and strength of different kinds. Economic competition does not threaten the United States. It may challenge us, it may even both us, but it does not threaten our security.

But neither does a positive trade balance with Japan save us from Soviet missiles, or them. Protection against missiles requires a defense against missiles. Consumer goods cannot deter aggression.

Economic power and military power are related, but they are not fungible. I believe that as long as the Soviet Union continues to choose guns instead of butter, it will be necessary for the United States to build guns of appropriate calibers and kinds.

Now, as long as new economic powers rise, and confront us with new economic problems, it is obviously necessary for us to compete effectively, to save more, and to manage our economic affairs in a creative fashion.

There is another problem, as I see it, with the way the question is posed. When we say, "Is the United States number one?" "Is the United States in decline?" and use the rise of economic strength of other powers as even oblique evidence that we are somehow in a relative decline.

I do not think it applies. I believe that the proof of American power is precisely the rise of successful, independent democratic nations. This is exactly what we have sought to achieve in the whole period since World War II.

We very deliberately set about to try to foster, and then to protect, a world of independent nations, and we were very clear about this. You know, Harry Truman, who not only planned these programs, but also explained them better than anyone, he said, and I quite: "We set up the means to feed and clothe and take care of physical needs of people. We rehabilitated the conquered nations instead of attempting to keep them conquered and prostrate. We asked for no reparations. Only America could take such an approach to world affairs. Our population, unlike that of other great nations, is made up of strains from every people around the world, and when we became the most powerful Nation in the world, we tried to put into effect the ideals of all races and nationalities which we had written into the Constitution and the Declaration of Independence."

Our goal since World War II has been to create and reinforce a world of independent nations with whom we can trade, with whom we can compete, from whom we can learn, and among whom we can travel.

We have deliberately sought to foster the success of others. We do not see their prosperity as our loss. Wealth, in our view, is not a zero-sum game. It is created through innovation and investment, work and growth. Increasing wealth of other nations does not diminish us, or anyone.

We think, to the contrary, that wealth needs to be shared through expanding markets in order to continue to grow. It is the pursuit of power in the international arena that produces rivalry because war, unlike economic power is a zero-sum affair. Political power is power over others.

We did not desire power over others. The fact that we may have less power over others today than at some past time is no indicator of American decline that any American, would accept if he thought about it a bit.

The U.S. system of alliances, as everyone knows, was developed as a part of an effort to safeguard the independence of other nations from Soviet expansion at a time those nations were devastated by war. Now they have grown stronger. Our European and Asian friends and allies are productive, sophisticated, and thriving. They no longer need the United States to bear the same burden of protecting their independence.

Obviously, they can assume a larger share of these burdens. Obviously, Japan today can and should assume fundamental responsibility for its own defense, not because the United States cannot bear these burdens, but because it is not reasonable that we should do so.

I think that our success of recent years can be measured not only by the fact that we have improved the performance of our economy, but also that we have done so during a time of increased expenditures.

Perhaps the very best demonstration that economic growth is not correlated negatively with defense expenditures is just that. It is the performance of the American economy during periods of increased defense expenditures, such as the Eisenhower years, and such, of course, as the Reagan years.

Our growth is a product of sound economic policies, policies that encourage freedom and reward innovation and hard work. I believe it is demonstrable that economic growth depends not on defense spending but on sound economic policies.

The United States today has the highest GNP in the world per capita, and no major industrialized country, including Japan, has made relative gains against the United States in the period since Ronald Reagan's economic policies took effect. This is very important.

It is in no sense a reproach to Professor Kennedy's analysis because all of us work with the data available, but a good many of his key tales only take account of data before 1981 or 1982, when the change began to be noted.

Concerning growth rates, for example, the American economy has grown at an average annual rate of 3.8 percent over the past 5 years, as of course compared to a 3.4-percent annual rate of growth during he 1976 through 1980 period.

During 1980 we were already in a recession. We have decreased inflation. We have created about 15 million new jobs during this recovery, unemployment has declined and is at its lowest point in almost a decade.

We have seen increased confidence in the American economy, and our economic growth rate, like our rate of productivity, is strong as compared to other industrial nations.

Now, we have some problems. We have a budget deficit, and obviously, our Federal deficit is our number one economic problem. That deficit needs to be reduced. We need to save more and consume less, and that is that. I believe that the solution to this problem is a balanced budget amendment, and I support that today, as I have supported it in other times and places.

There are other countries which have tried just such strategies to bring undisciplined budgets under some kind of control. The Fifth Republic in France is a good example of that. It has worked for them. I think it could work for us.

The trade deficit is our number two economic problem. We obviously need to produce more than we consume. We obviously should work to bring down imports and bring up exports. I also believe that we should demand access to markets in exchange to access to American markets, and that we should do so promptly and effectively.

Finally, we do have some serious problems of equity. I am particularly concerned that households in our country headed by women are falling behind the general prosperity, and some minorities are not keeping up, but I believe that we are nonetheless operating today from a position of great strength, and in a new world.

We have new competitors, and we have the same old potential military threat. All that is required, I believe, for the United States and the world to meet that military threat, is to continue to be as strong in all relevant domains as the Soviet Union.

It is they, unfortunately, who dictate the necessary level of defense spending, but as the distinguished economist at the American Enterprise Institute, Herbert Stein noted recently: The United States can afford to spend as much money on our defense as we need to spend.

The future like the past, is a product of the intelligence of our policies, our attention to the lessons of the past, and our reliance on personal motivation and individual freedom in the pursuit of both wealth and strength. Thank you.

Chairman CHILES. Thank you, Ambassador. Professor Kennedy, I wonder if you would like a moment or so to respond to Ambassador

Kirkpatrick's review of your book, and then we will start our questioning.

Professor **Kennedy**. I would be happy to, Mr. Chairman. Thank you. I am obviously not going to go into all of the points made by Ambassador Kirkpatrick. Let me, however, pick out one or two.

Chairman **Chiles**. We do not have time.

Professor **Kennedy**. I would guess that is so. There is an important remark made there about Russian and the Soviet Union which I think is worth deliberation, and it is Ambassodor Kirkpatrick's observation that the Soviet Union refutes the idea that keeping defense expenditures in line with economic base—which I see as a balance necessary for all states—it refutes that historical principle in insuring long-term growth.

My own sense of the history of both czarist Russia and the Soviet Union is that it did not refute, it did not defy the laws of economic power eventually equalling military power. Russia rose to the fore as a great power when Peter the Great modernized Russia in the early 18th century.

Without that modernization, Russia would have been as backward, relative to the West, as it had been. Russia, in the 19th century, falls behind because it does not put enough of its national resources into long-term infrastructural development.

It puts too much into the military. Russia comes a cropper in the Crimean War, the Russo-Japanese War, and the First World War, because it is militarily top heavy.

What happens in the interwar years, in consequences of Stalin's plans, is that an absolutely extraordinary amount of Russian resources are put into infrastructure, industry, technology, science and education, which allow it to withstand the German onslaught of 1941.

Russia is not an economic pygmy in 1941. It is going well past even Nazi Germany in its total output. What has been happening over the past few years, however, is that Russia has, once again, returned to its czarist habit of putting too much of its national resources into military expenditures at the cost—there has always been in Russia at a cost of its consumption, because consumption in Russia has always been much less than in the West.

But it has also been at the cost of investment in long-term research and development, in education, in infrastructure which is falling apart, and in a whole number of other indicators of where it is likley to be in the early 21st century.

Far from refuting the case, I would submit that Russia is a classic example, like imperial Spain, like the France of Louis XIV, and a number of other historical cases of where a power seemed to be great because it had put a large amount of its resources into military strength.

It obviously worried its neighbors. It obviously was a danger. No one is saying that the answser to the build-up of Louis the XIV's army in the late 18th century was to say, don't build an army or navy of yourself.

But there is, over the long term, a very distinct correlation between the economic staying power of any system and its military/strategical staying power, and countries which look big and imposing in front-line military terms, but are not competing in long-term technological/industrial terms, have an even greater problem, I would submit, than the ones we are talking about for the U.S.A. today.

The ones we are talking about for the U.S.A. today, Ambassador Kirkpatrick has reminded us, are relative. They are relative to what has gone on over the past four decades.

The world system, as exists today, is indeed very much a creation of American generosity and farsightedness from 1945 onwards. It wanted to create a free world, free-market economy, and it gave of its resources so to do, and it has, to 90 percent of the time achieved that aim. Of that there is no doubt.

But it seems to me that to argue that because the rest of the free world has risen up, some of them remarkably risen up in economic, productive, technological competitive terms, is a total gain for this country, and one which does not call into question, or only marginally calls into question a consideration of relations with the allies in respect of our overseas military obligations, is, to my mind, flying in the face of these long-term economic trends.

In this respect, I believe the difference between myself and Ambassador Kirkpatrick would be one of degree. We are both saying that the allies ought to bear a larger share of the defense burden now because their share of total world output and manufacturing is much larger than in 1947 or 1951.

I have a concern, though, about placing the emphasis too heavily on military strength. It is certainly not the case that in the book I say the United States is overspending as a simple statement of fact.

I am worried about the degree of American military spending as a measure, and an obsessive measure of its strength in the world, as opposed to the amount which it may be putting into engineering and scientific education for the long term, into its own infrastructure, into basic science, and into doing something with the deficit.

There is one final remark I would like to make, Mr. Chairman.

What Ambassador Kirkpatrick said was very compelling and very fluent. It reminded me, though, of the sort of compelling and fluent statements made to Olivares of Spain in 1640, and to some of Napoleon's advisors, and to the British prime minister and the cabinet around 1903 and 1905. Things really are not so bad, that we can keep on like this.

It is all relative, not absolute. We still are rich. They are our friends who are growing more prosperous, aren't they?

Those sort of statements seem to me perfectly valid, but I would also say they have distinct historical echoes, and what I fear is that with that degree of saying things are not so bad, there will be a tendency not to push ahead with what I regard as a combination of external and internal restructuring in the future.

Thank you, Mr. Chairman.

Chairman CHILES. Thank you.

Professor Kennedy, when I heard Ambassador Kirkpatrick, I think she said you spoke about the relativeness of guns, butter, and investment. My understanding was that there were four pillars, and the one left out is debt. Is that not a part of the thesis—consumption, I think you called it—defense expenditures, future investment in debt management or repayment?

Professor **Kennedy**. I think in a more sophisticated model that would be so, Mr. Chairman. That is to say, the argument here, and the argument of economic historians, is that all societies have a tradeoff as between the amount they put into: first, consumption, which is what we normally put most into, because we normally consume most of what we produce; into defense expenditures for the protection of our national interests, into investment for the future, in the terms—I described it in detail here; and finally, if there is a national debt, into the payment of the interest, or, in some societies, the paying off of the principal of the national debt.

I fear that in another respect I tend not to share Ambassador Kirkpatrick's rendition of this country's prosperity and economic growth in the 1980's, and it was the extent to which that may well have been funded by the inpouring of foreign monies to cover the gap between Federal Government expenditures and Federal Government revenue.

The rise in the national debt of this country over the past 7 years, and the way in which this country has turned from being the world's greatest creditor Nation to being the world's greatest debtor Nation, in the space of 6 to 7 years, is one in which I, as a historian, have enormous difficulty in finding a precedent for. I have never seen anything like this in the 500 years, of studying great power finances and central government deficits, that I have seen in this decade.

Chairman **Chiles**. I will yield to you, Senator Domenici.

Senator **Domenici**. Thank you very much, Mr. Chairman.

Let me just say to the Ambassador that I am very bothered by this whole subject, and I am not a fan of Dr. Teller, as a scientist, any more. I used to think that his effectiveness was measured, in science, by the size of his eyebrows, but I have become convinced that he has seen his day in that area.

But let me tell you I happened to read an essay where a writer was trying to ascertain—from people that he perceived to be gifted Americans—was trying to perceive from them what they thought about our 200th anniversary under our Constitution.

And he was attempting to get them to talk about, in the scope of history, what a great 200 years this had been, and how we probably were going to have a very measurable impact upon all of civilization. And Teller was the only one on the list that would not admit that, except that he said one thing.

"I would have to say that at the end of the Second World War, America made a decision that leads me to believe that she may, over the scope of history, contribute immensely to civilization."

And when I read that much, I said I will finish this. What in the world would he say. And interestingly enough, he said what you just said. He said: "The most significant decision that this civil country with all its freedoms ever made, thus far in its 200 years, was not to punish its enemies, not to seek reparation from those that it went to war with, but, rather, to invite, and indeed, subsidize a growing, free industrialized set of countries."

If I read you right, while you are not saying that is its one triple A, you are concluding that that is a—in a sense, might I borrow from the subject matter—an empire-building of another sort, an empire-building of freedom and democracy vis-a-vis what we saw, and what President Truman saw, as this monstrous society called the Soviet Union.

And if I read you correctly, you are agreeing that that is a very big plus in terms of the world, and America's interests in the world. Am I reading you correctly?

Ambassador KIRKPATRICK. Yes; Senator. You are.

Senator DOMENICI. Now, let me ask you this. It seems to me that maybe both you and Professor Kennedy are saying the following, and then I want to ask you a question about the Soviet Union.

It seems to me that you may both be saying if the United States of America and her allies perceive the Soviet threat to be significant enough, we must spend what we must to make sure that that threat is restrained in the world.

I read that. I do not think you are saying—if I read you, Madam Ambassador—I do not think that you are saying that others should not share in that burden, if we can find a set of policies to get it done without removing the power base of the free world versus the Soviet Union.

Is that what you are saying?

Ambassador KIRKPATRICK. Yes, Senator Domenici. I very much think so. If I may add, I believe that at the end of World War II, the United States did——

Chairman CHILES. Pull your mike up again.

Ambassador KIRKPATRICK. Under the leadership of President Truman at the end of World War II, we did seek to shape a world to our vision of what the world would be, what we would like it to be, and what we wanted it to be was a world of independent self-governing nations in which each people tried to realize its own destiny, future.

I think that we have felt since then, that this world, and this vision of the world was in some conflict with the Soviets' vision of the world, which is a much more classical, imperial vision of the world.

And we have thought it necessary to have large defense establishments, and that is expensive. I think all Americans detest large military expenditures, let me say, all parties and through all times. We detest it.

We have nonetheless thought it was necessary. I think certainly it is still necessary to seek to preserve a world of independent nations, which we are still trying to do.

Senator DOMENICI. Well, let me just make two points and see if you would comment briefly.

First, it seems to me that the risk involved in the notion of burdensharing, is tying it directly to America's competitiveness. It seems to me that if we do not make the right policy decisions with reference to the American economy, the mere act of burdensharing may not accomplish anything.

I mean, what I am concerned about is—and I read it in the summaries of your book, Professor Kennedy—that you are saying we must exercise some policy changes domestically, regardless of defense expenditures, that will permit our natural competitiveness and capabilities to match up and defeat, if possible, those new countries that we urged to become creative.

And so I do not see the tradeoff as one for one. We cut defense or we reduce defense.

If we do not do the things you have described, and if this country is not vested with the quality described in terms of our individual effort and productive capacity, the mere cutting of defense or burdensharing is not going to solve the economic problems.

Am I reading you right, Professor, that that is probably true?

Professor **Kennedy**. You are indeed, sir, yes.

Senator **Domenici**. Now it seems to me that there is one other issue that I am not sure I agree with you on, Professor.

You indicate that the Soviet Union inherited a rather developed country. It appears to me that that is right, and they have proceeded from that point forward, and the infrastructure that they inherited, they have used under a regime of dictatorship.

But I do not conclude that the Soviet Union is economically weak because they have spent too much on defense. Frankly, I conclude that this world is moving too rapidly for the Soviet Union, for her system, when I see that some major American companies' products are only 3 years old—50, 60 percent of their total sales, or 50 percent are only 3 years old, as products. I believe the Soviet Union is in economic decay because that system cannot change that rapidly and apply technology and innovation that quickly.

I do not believe it is solely because they spend too much on defense.

Professor **Kennedy**. I was going to say before, Senator, that I think that internal strength and external strength really are——

Senator **Domenici**. Right.

Professor **Kennedy**. Two sides of the same coin, and that in the case of the Soviet Union, it is quite clear it is not well-structured to meet the high-tech revolution which is bearing down on us.

But I think it is less well-structured, and as I understand Mr. Gorbachev, he thinks it is less well-structured because it may be spending about 16 percent of its GNP on defense.

If it was spending much less than that, it could use those resources for investment in the future. It may not decide to reduce that because of its paranoia about the world outside, and because it probably perceives the world as tilting much more against it as it goes into the early 21st century than before.

But can I answer it in terms of something rather concrete, and coming back to your first remark. Something as concrete, say, as the production of engineers, which is vital for a flourishing productive base in any country.

This country now is producing less engineers out of its engineering professional schools each year than Japan. The number of Ph.D.s each year in Japan are more than in the United States. But when you look at the U.S. total you discover that 60 to 61 percent are not American citizens.

They are foreigners coming here, some to stay and some to go. If therefore, in the future, one decided to put too much—and this is all a question of balance—too much American national resources into, say, high-tech military development, that would have the inevitable effect of taking away from the small number of engineers we have into defense and away from commercial competitiveness, while the Japanese proceed in a different direction.

In the same way I think the Soviet Union has a similar problem: where is it going to put its engineers for the early 21st century? If it keeps them up in defense at the rate it does, it is going to weaken itself. So we all have tradeoffs, but the Soviet Union is in a much weaker position.

Senator **Domenici**. Thank you, Mr. Chairman.

Chairman **Chiles**. Senator Sasser.

Senator **Sasser**. Thank you, Mr. Chairman.

Professor Kennedy, I am in the process of reading your book. I say the process because it is a fascinating book and extraordinarily well-written, but it does take some time to read.

But you do say in the book—and I think this is a direct quote: "Excessive arms spending will hurt economic growth."

Another quote: "Without a rough balance between the competing demands of defense, comsumption and investment, the Great Power is unlikely to preserve its status for long."

Two questions: Do you think our defense spending, our spending for arms is indeed excessive at the present time, and, if so, should we move further down the road to a negative balance as far as arms spending is concerned?

As you know, we had a very rapid run-up in defense spending for 3, or 4, or 5 years, and now we are in the process of that coming down, slightly, each year.

Question: Are we in the posture of excessive arms spending, or should we move down the road to lowering our spending for arms? Those are questions that policymakers are supposed to answer, but we ask for your counsel.

Professor **Kennedy**. The very tricky adjective of this question, Senator, as you well realize, is the word excessive. What can be excessive for the Irish Republic may not be excessive for Israel at the present moment. This is not a very good guide to begin with because it is saying that judgment and balance are needed here, and there is no absolute guide.

This country was spending 10 percent of its gross national product under Eisenhower. He thought it was excessive and he wrote a lot about it, but nonetheless, I do not think, in historical terms, it was, because the U.S.A. was, relatively speaking, so much stronger.

Six percent now may be rather more problematic than 10 percent then. When one goes into the middle of a great war you can be spending 52 percent of GNP on armaments, or even more, but you are fighting a war so you have to do it.

What I would say is that it is not excessive, (a) if you are threatened by another power which is clearly spending more, and seems to have an evident intent to trespass on your interests.

And (b) it is not excessive if you are taking a concomitant set of measures to make sure that your productive economic base is flourishing, so you can keep paying for the armed services.

But if, for example, you are not investing in the future, you are only paying—this is our 4-way tradeoff, Mr. Chairman—if you are only paying for consumption and defense expenditure, then you would be in trouble.

I see, at the moment, the 6 percent as probably being around what the United States should be paying for until (a) it becomes clearer what is happening in the Soviet Union, and (b) it moves to getting a rather fairer share from the U.S.A.'s allies.

I would worry about an increase up to 7, 8, or 9 percent, because I think that would be the effect I talked about a minute ago in terms of draining off engineers and scientists, and undercutting one's base.

Six percent I would have thought at the moment, in the circumstances of a relationship with the U.S.S.R., and with allies in Europe and Japan, is probably about it. It could go down if both of those other relationships were changed.

Senator **Sasser**. So it is really a subjective judgment, based, I suppose, on geopolitical considerations, as to whether or not your spending for arms is excessive, for any great power, based on what you believe to be your own security requirements, and what you believe to be the threat to your security.

Now, I think perhaps it is a measure of the threat that drives defense spending. In fact I think that is what drives it. I am delighted to see that both you and Ambassador Kirkpatrick agree that we ought to have a greater contribution from our allies.

That is something I have thought for a long period of time, and I think others here have been saying that.

Let me give you a proposition that we have heard repeated some in recent years, and that is, our GNP is twice as large as that of the U.S.S.R.

That we can afford to engage in this arms race longer than they can. That as a matter of fact, we are getting them right where we want them. As evidence of that, Mr. Gorbachev is now coming around on a number of issues.

They seem to be very frightened that we are going to go forward with SDI because then they would be forced to try to match United States' expenditures in that field.

What do you say to the argument that let's just keep on spending and spend the Soviets into bankruptcy? They cannot stand the pace.

Professor **Kennedy**. My guess, knowing the Russian/Soviet political culture, Senator, would be, if they heard that argument they would say we will resist, we will spend, we will dig deeper into our pockets. We will reduce even our miserable level of consumption right now.

My other comment would be that the danger of that, as I see it, is that too heavy a concentration on an arms race by the two leading military powers of the world would allow other countries, admittedly allies and friends of us, to concentrate more of their resources on arranging themselves commercially, an technologically, for the early 21st century.

The great beneficiaries of a spiralling United States-Soviet Union arms race would be Japan, possibly China, West Germany, and other countries. They would say, why don't you rush ahead, keeping yourself locked into this dynamic of an arms race, and we will inherit the commercial parts of the Earth?

Senator **Sasser**. Well, the argument can be made that the Japanese are already inheriting the benefit of the arms race between the Soviet Union and the United States.

You also note in your book and you seem to be urging that Japan should substantially increase its military spending. Now, there are those in Asia who remember the great Eastern coprosperity sphere fear that the Japanese were advocating in the 1930's and 1940's, and they do not want any more of it.

Is there some way that we could encourage, in your view, an increased Japanese defense expenditure without being provocative, and one approach that I have advanced is that the Japanese, rather than the Toyota plants turning out tanks—which I do not find very reassuring—remembering the history of the Japanese in the 1930's and 1940's in the Pacific—one idea that I have advanced is that the Japanese aid the United States in defraying the cost of our military bases around the world.

For example, we are on the verge of renegotiating new lease agreements in the Philippines. Now we are presently paying for those bases about $180 million.

Some Philippine legislators are saying that this needs to be raised to the figure of $1.2 billion annually. These are just the bases in the Philippines.

Now, my question is: Would this, in your view, be a way by which the Japanese could contribute to the common defense, that would be acceptable and nonprovocative, and would you encourage that, if you were a legislator? And I will pose that question to the Ambassador also.

Professor **Kennedy**. Shall I answer first?

Senator **Sasser**. Yes, please.

Professor **Kennedy**. I feel somewhat perturbed, Senator, at the notion that burdensharing, as between the United States and its allies in the Pacific, and perhaps also in Europe, would increasingly take the form of the United States having the bases, providing the troops, providing the armed services, and those other countries paying for it.

It would be an ironic commentary upon the 200 years of the American Revolution, if this country turned itself into the Hessians of the late 20th century, for whatever good reason.

I am well aware, that in the Philippines, in Singapore, parts of the northern territories of Australia, and elsewhere in East Asia, there is a concern about a Japan, some time in the future, developing large armed forces and flexing its military muscles.

I think one ought to admit that, and therefore, the conundrum of trying to get the Japanese to increase their share of the defense burden without alarming Filipinos, or Mr. Lee Quan Yu, is going to be a difficult one.

On the other hand, I think there could be an argument for particular weapon systems, and particular defense roles. I think that what alarmed all of Southeast Asia, and the memory they have of Japanese military aggressions in the 1930's and 1940's, is, of course, of a very, very considerable Japanese army, an army of 3- to 4-million strong, 2.5 million in China and elsewhere.

A Japan perhaps concentrating more on the protection of the sea lanes, on submarine warfare and technology, and on tactical air, to help the United States and everyone else in the Far East, may be a different proposition from a Japan with a large army that one remembers from 1941, or 1944.

I think that Japan, in its own due time, is likely—though at the moment there is internal opposition to it—likely to increase its defense spending, and it might be worthwhile thinking of the ways in which it should be encouraged to do, rather than the ways it may incline to do.

Senator **Sasser**. Do you wish to comment on that, Madam Ambassador?

Ambassador **Kirkpatrick**. Yes, Senator; I would be very happy to.

I would begin by noting that Japan is already providing more aid to the Philippines than we are. Quite a lot more, as I recall.

I also think that I agree wholly with Professor Kennedy, that we Americans do not have a military vocation. The last thing we want to accept is the role of defending with our troops, and our forces, all the outposts of the world for pay by the nations whom we are defending. That would not be at all consistent with our vision of ourselves, or our vocations in history.

I do think, however, that yes, the Japanese should pay a larger share of whatever costs there are for the security of that region, including the Philippines. I believe that theories have to give way to new realities. And that what we really need is a new alliance system for the Pacific, that we need to restructure the shape and the content of our alliance system in the Pacific, and in that context redistribute burdens so that both the military and the financial burdens are more equitably distributed.

Senator **Sasser**. My time has expired.

Chairman **Chiles**. Senator Conrad.

Senator **Conrad**. Thank you, Mr. Chairman. I just thought I would comment on Ambassador Kirkpatrick's point that the relative position of the United States has not slipped with current economic policy.

It reminds me a little of the end of World War II, when the German high command kept reporting the victory is closer to Berlin.

We have tripled the national debt, and seen a sixfold increase in the trade deficit. We have become a debtor nation for the first time since 1914, and it strikes me that we have lost a great deal in relative position.

The question I have really goes to Mr. Kennedy. I, too, am reading your book, and I think the reason it has had such an impact is that it is so relevant to the policy questions we face today. I think, in fact, you have hit on what may well be one of the key points that we must cope with as policymakers.

Isn't the question of who is number one really missing the point? Isn't the point you are making, that both the Soviets and the United States are experiencing relatively sluggish economic growth because both of us are giving a disproportionate share of our resources to military concerns vis-a-vis what our competitors are doing?

Professor **Kennedy**. I would say, Senator, that the question, who is number one is very important in a bipolar world where you face the possibility of military exchange, or military conflict, because if it is a bipolar world and you are number two, then that is a very significant problem.

But I do not believe that the early 21st century, except in certain respects, which may become less significant, will see us in a bipolar world. I think it will see us in a multipolar world, and if the present alliance relationships continue, it will see four powers, the United States probably still the largest concentration of economic and military muscle—but four powers on one side, and the Soviet Union in a rather desperate position on the other side. We are also going towards that early 21st century with two military superpowers spending—the Soviet Union admittedly spending much more—but both military superpowers spending a larger share of their national resources on defense than the others, puts them at a disadvantage to invest in the future and to position themselves for the early 21st century.

I repeat, again, that the 6 percent of GNP spent by the U.S.A. is not, of itself, a concern, were the U.S.A. putting a much larger percent into investment for the future, in terms of research and development, infrastructure, growth, and everything else like that. But putting 6 percent into defense expenditure, and having a high consumption rate, having a burgeoning debt, and not investing in the future, is a concatenation of worries that I have about the next few years.

Senator CONRAD. Let me just ask if you have had a chance to review the World Watch study that was done a number of years ago that looked at the long-term trends for both the Soviets, the United States, our major economic competitors, and concluded that both the Soviets and the United States—Soviets to a much more serious degree than we—were headed toward serious competitive problems because of this disproportionate investment in military, vis-a-vis what our competitors are doing.

That they are taking the dividend, they are taking the advantage and investing it in education for their kids. They are investing in the ability to produce consumer products that dominate the international marketplace.

Have you had a chance to look at that report?

Professor KENNEDY. Yes; I know that, and a number of the other publications of World Watch which I find extremely useful, indeed, for my own work.

We would, again, of course, have to say that the Soviet Union in a much worse position. Nobody is trying to equate the position of the U.S.A. in terms of being structured to meet the early 21st century, with that of the Soviet Union.

I think it is clearly in a much worse position. It is, however, the case, in terms of simple arithmetic, that if you are spending 6 percent of GNP on defense and Japan is spending 1 percent on defense, Japan has 5 percent left to do something else with.

And I think we know from gross investment figures, and the extraordinary rise of Japanese investment in commercial research and development, where that something else is going.

As I see it, the U.S.A. is—I will not say a cleft stick, because that means—that suggests you cannot get out of it. But it has to measure itself along a spectrum of possibilities in which at the far end the Soviet Union is spending 15 or 16 percent of GNP on defense, and therefore is posing a military threat, potentially in all sorts of ways, and that of Japan, which is spending 1 percent, and is posing a competitive commercial technological threat.

If it approaches the Soviet Union's level, it undercuts its own productive base. If it reduces defense expenditures down to Japan's level, and keeps all of its commitments that it has at the moment, it runs a risk of being defenseless in the world to meet those obligations and commitment.

It is a fine balance that it has to draw, and it is not an easy one.

Senator **Conrad**. Mr. Chairman, my time has virtually concluded, but I would just like to make a final observation.

I have been all across my State and had hundreds of community forums in the last year. The people in my State really cannot understand the logic of our paying for the defense of our allies, and borrowing the money from them to do it.

That bottom line they find very difficult to understand.

I want to thank all of the witnesses for being here today. We certainly have benefited from this exchange.

Chairman **Chiles**. Professor Kennedy, I read your book a little differently than some of the other people. As I read it, you are as concerned about our unbridled consumption and our failure to pay for it.

Am I incorrect in that?

Professor **Kennedy**. No, sir, but let me explain that in the complicated schedule I had last week, on the other side of the country, in trying to write a submission for your committee, and for this morning's House Armed Services panel on defense burdensharing, I took it that the thrust of my submission to this morning's panel was about defense burdensharing, and that to the Senate Budget Committee it was this larger tradeoff between the various elements, the four elements I have described.

I now realize that the thrust of what is going on here is indeed another debate upon burdensharing, but in my own written submission, and of course in appendix B, I do draw attention to the fact that one of the elements in the tradeoff is consumption, and it is the most difficult element, politically, especially in a democratic state, to deal with.

Because even if it appears that the logic points to a decrease in consumption, whether by reducing entitlements or by increasing taxes, in order to do the other things that are needed to be done—to pay the interest on the debt, to keep up the armed forces, to invest in the future—even if the logic is that some has to come out of consumption, it is very difficult for political leaders to handle, especially in an election year.

And yet I feel that to reject that, to have a knee-jerk reaction every time someone mentions the dread word taxes, or, let's have a look at entitlements, is a very distinct echo of societies in the past which have wanted consumption, they have wanted big defense expenditures, they have national debt payments to make. They have not been willing to consider either tax increases or the entitlements to which the State has given them.

I do not know how to get out of that politically, but I would say historically, things would need to be done. I am concerned about it.

Chairman **Chiles**. Madam Ambassador, in your treatise you talked about Russia since the revolution in 1917. You suggested it defies historical comparison, that you cannot spend enough on defense and be a strong power elsewhere.

The Russians are able to do something about their consumption, and have effectively done it over a long period of years. It seems we have not been able to do that.

Certainly we do not want to do it the way they do it. We cannot compare ourselves. Russia can spend what it wants on armament regardless of whether they are a superpower or not, because we cannot rein in our consumption. We never would be willing to do it the way they do it. Do we not then have to be concerned about keeping our economic engine running and healthy at all times so that we will be able to provide the defense for ourselves for the free world as well?

Ambassador **Kirkpatrick**. Senator Chiles, I believe that, of course we do not want to impose on ourselves the kinds of constraints that the Soviet Government imposes on the Soviet people. We do not want to impose on ourselves those kinds of constraints on consumption.

We want the kind of very high and comfortable standards of living which we enjoy, and which we hope for other people, including the Soviets.

I believe, however, like Professor Kennedy, that the problem's solution finally depends on making wise choices between guns and butter and investment.

What we Americans have been trying to say, maybe to our danger and our detriment, is that we do not have to choose between guns and butter. We have been saying that, at least since the mid-1960's. I guess President Johnson was the one who said it most explicitly, but I think in saying it, he fundamentally captured the spirit of most American Presidents and administrations of both parties.

And what we have done is neglect investment, and what the Soviets do in imposing those very low standards of living on the Soviet people, is force savings which they use for investment in their economy. We do not do that, and that is I think a disadvantage. And I think that the only viable solution, the only one appropriate to a free society and a free people, is that we come to understand that we really need to save more and invest more, and do it.

But I agree it is important, and that we have not been doing it adequately.

Chairman **Chiles**. Well, you raised another very important point, I think initially, when you mentioned that it was time for some kind of a new alliance in the Pacific.

With all that we have said about the Marshall Plan and Truman Doctrine, about rebuilding Europe and the Pacific, at some stage can we claim success and say we have done it? We ought to be able to say it now. Look at the models we have in Japan, Korea, Taiwan, and the European Community. Now is the time for a new era in which the democracies we have helped establish assume a proper role and responsibility.

In the Pacific, there is no sort of burdensharing. Yet last year, we managed to forgive major indebtedness on the part of Korea for arms we had furnished to them. I do not know why that was necessary but we did it. Still we find they are spending very little to provide an umbrealla for themselves.

Ambassador **Kirkpatrick**. Senator, yes, I agree with you. I believe that our plans were a great success and while I think we can in fact continue to bear the burdens which we now do, it does not make such sense. I believe that we need to join with our good friends and allies in the Pacific, and in Europe, and in Latin America, and perhaps in the Middle East, and put some questions about how we ought to organize ourselves for this era, to protect the independence of all of us which we all cherish.

I think, frankly, that this is the great challenge to us in the future, and maybe this is what Professor Kenendy had in mind when he said the question before us was how we adapt to the new world in which we find ourselves. The new era is upon us, and I do not think we can go on responding in old frameworks.

Chairman **Chiles**. I think that is perhaps a good note on which to end our hearing. We again thank each of you for coming. It has been a very interesting and provocative hearing, and you have given us much to think about as we go forward. Thank you very much.

[Whereupon, at 4:11 p.m., the committee was adjourned.]

YALE UNIVERSITY

PAUL M. KENNEDY
J. Richardson Dilworth
Professor of History

Department of History
Box 1504A Yale Station
New Haven, Connecticut 06520
Telephone (203) 432-0554 or
(203) 432-1366

April 11, 1988

Senator Frank R. Lautenberg
United States Senate
Washington, DC 20510-6100

Re: Senator Lawton Chiles

Dear Senator Lautenberg:

I am very much obliged to you for your questions (passed on to me by Senator Chiles) respecting defense burdensharing. I will offer but brief replies to each of them in this letter, but will willingly elaborate on any points you would wish me to develop.

I think we all know that this issue of "burdensharing" is an extremely complex matter, because we are not always comparing like with like. To begin with, the United States is a true global power in the way that our allies are not; it has obligations and deployments in, say, Okinawa and South Korea which European allies do not -- conversely, it has obligations and deployments in the Fulda Gap which Japan has not. It strives to be strong in all spheres, whereas others are more specialized (e.g., the Germans have a strong tank army, but a small navy). As such, the United States is likely to be spending more than the others on weapons and bases. Secondly, countries such as West Germany pay a certain "social cost" in maintaining conscription, but that does not easily translate into dollar and GNP comparisons.

Nevertheless, when all those allowances are made, the basic fact remains that this country spends a far larger share of its national resources upon defense than do our allies, which leaves them with more resources to allocate elsewhere. In the case of our European friends, I suspect that those "more resources" go into their larger social-security programs; in Japan's case, into savings and investment (thus making its economy more competitive).

I believe that it is very desirable for the next administration of this country to use all its diplomatic and political skills to persuade our allies that the defense burdens should be more equitably borne. I think we have an irrefutably strong argument that it is not in their own long-term interests that the United States should carry such a disproportionate load, with consequences both upon American public opinion and upon our economic competitiveness and strength.

I also feel that this debate should be conducted in a mature, wide-ranging and sophisticated way -- taking in mind (a) the possibility that the Russians may also be looking to reduce their defense spending, and that demographic trends within the USSR will cause the overall size of their armed forces to shrink; (b) the notion that more specialized military/strategic roles might be worked out with our allies (for example, the United States to concentrate more on tactical air forces -- where it is unequalled -- in both Germany and the Far East, but allies to increase their concentration upon ground forces); and (c) the notion that, especially in Japan's case, steady and modest increases in its naval and air forces could be accompanied by very substantial increases in its economic assistance, e.g., in aid to the Third World.

While I don't expect massive increases in defense spending by our European and Japanese allies (they, too, have their internal critics and lobbies), I remain cautiously optimistic that something can be done. It surely is going to be high on the diplomatic agenda from January 1989 onwards.

But any relief which the United States gained from a reduction in defense expenditures would be wasted, in my view, if that money simply went into personal consumption (which then, most probably would go into our buying more imported goods). Even the advantages of using the savings to reduce the Federal deficit -- which I regard as a very high priority -- may not be as important as investing that money into this country's long-term future: that is, boosting basic research, increasing the flow of American engineers and scientists, assisting the school system, encouraging a large rise in funds for commercial R & D. All of the latter have, historically, been good indications of a nation's future prospects. Moreover -- and this is the critical final point -- on an enhanced technological and manufacturing base, this country will be better able to bear the burden of defense in the future.

I've noticed that certain right-wing critics of my book The Rise and Fall of the Great Powers have attacked it for being "defeatist" and "inevitabilist," which is a remarkable misreading of its thesis. The United States, like previous Number One world powers before it, faces a great challenge because it carries an enormous array of strategical obligations with an economy that has not been growing as fast as others. Like those previous Great Powers, this country has certain options open to it -- to strike a better balance between its capacities and its obligations, and (especially) to ensure that it remains economically strong. There is nothing "inevitable" about the future. Whether it makes the right choices to strengthen its competitiveness -- or whether (like Great Powers of the past) it is inhibited from doing so by cultural and political objections to change -- will depend upon the wisdom of the American public and its elected representatives. The options are ours.

Yours sincerely,

P.K.

Paul Kennedy

PK:sk

VIEWS OF THE SECRETARY OF DEFENSE

THURSDAY, MARCH 3, 1988

U.S. Senate,
Committee on the Budget,
Washington, DC.

The committee met, pursuant to notice, at 9:44 a.m., in room SD-608, Dirksen Senate Office Building, Hon. Lawton Chiles (chairman of the committee) presiding.

Present: Senators Chiles, Hollings, Johnston, Sasser, Exon, Sanford, Wirth, Conrad, Domenici, Symms, Grassley, Kasten, Danforth, and Nickles.

Staff present: Richard N. Brandon, staff director; and Doug Cook, group leader for national security.

For the minority: G. William Hoagland, staff director; and Richard Doyle, senior analyst for defense.

OPENING STATEMENT OF CHAIRMAN CHILES

Chairman Chiles. Good morning.

We are pleased to have with us today Secretary of Defense Frank Carlucci, and the Chairman of the Joint Chiefs of Staff, Admiral Crowe. Welcome to the Senate Budget Committee.

Mr. Secretary, in the last few months I have heard it said over and over again that the decisionmakers chosen this next fall will have a very tough time next year. A new President will be in the White House; Congress will have its share of new voices, and expectations will be high—but so will the deficit, and so will the national debt.

With that in mind, I think you deserve special recognition as one of the first to stand up to those choices and begin making them right now. You have given Congress a defense budget that doesn't buy out the store.

Some people are not happy. Maybe none of us are thrilled. But I can have nothing but respect for the tough judgment you have exercised in the name of a strong national defense.

This week the President is in Brussels to renew our 40-year-old commitment to the NATO alliance. Both our European allies and the United States have gained a great deal from our long association.

But even while we reaffirm our alliance, former U.N. Ambassador Jean Kirkpatrick has talked to this committee about fresh realism in foreign affairs. Two days ago, she told us that "we need to join with our good friends and allies in the Pacific and in Europe and in Latin America and perhaps in the Middle East and put some questions about how we ought to organize ourselves to protect the independence of us all."

I think she has a point. The subject was defense burdensharing, and we were discussing the possibility of our allies becoming more active partners in our defense network.

No one can doubt our country's commitment to freedom. In the last 25 years, NATO has outspent the Warsaw Pact nations to keep our defenses strong. The lion's share of that load has been carried by the United States.

At the end of World War II, we accounted for roughly 50 percent of the world's gross national product. Today it is less than half that, because the nations that grew with our help have become vigorous competitors in world markets.

Yet while our share of the world's wealth is relatively less, the contribution we make to the alliances remains very high. So it seems reasonable to ask how those with new wealth—acquired in a world made more stable by American sacrifice—might carry more of freedom's burden.

I think it is time we look harder for ways that we can share weapons production with our allies. We need to explore how we develop more compatibility between systems so that guns built overseas can fire bullets made here.

We need more balanced participation among our allies to keep our alliances strong, but we also need balance within our own defense etablishment.

Despite a massive buildup in our military during this decade, some things have been short-changed. Basic research sponsored by the Department of Defense made no great funding strides during the last several years, nor have we done enough basic research on conventional weapons.

We have spent billions, perhaps a great deal more than we thought, to develop an invisible bomber. But we have yet to develop a reliable anti-tank weapon that a soldier can carry in the field.

And although we are firm in our faith with NATO, we still have not worked out a reliable way to provide close air support for our ground forces.

Prof. Paul Kennedy was with us this week. He told us that we are facing a four-way trade-off between investment, consumption, debt repayment, and our defense spending. He believes that unless we resolve these issues, we could end up extended beyond our ability to deliver.

You have intimated much the same thing in our public statements. I do not think that that has to happen, but I am afraid that it might very well take place unless we are sharp enough and wise enough to get the most out of our defense dollars, and more help from our allies.

All of us here understand the United States will always do what is necessary to preserve our freedom. There have been times when the cost has been measured in tens of thousads of lives. There have been times when it has been measured in trillions of dollars.

And now the cost is to find the measured judgment that will allow this country to grow strong, and with the help of our allies, keep us all free.

I have no doubt we can do it. We need your advice and guidance on the best ways to make sure it is done, and we certainly welcome your views. We look forward to your testimony.

And Admiral Crowe, we are also delighted to have you as Chairman of our Joint Chiefs here.

Senator Domenici.

OPENING STATEMENT OF SENATOR DOMENICI

Senator Domenici. Thank you very much, Mr. Chairman.

Mr. Secretary, Admiral Crowe, welcome. Let me first congratulate both of you on the enormous undertaking that you did in a short 3 or 4 months after the economic summit in arriving at a total new military game plan.

I hope everyone understands that, not in reference to a wish list, but actually what the U.S. Department of Defense had planned to spend on personnel, the maintenance of our facilities and equipment, and procurement, you had to reduce that budget by some $33 billion in that 4-month period between the economic summit and your submission of the budget—actually, less than 4 months. And I commend you for it.

But I also think we ought to say that for those who are critical of the fact that defense would have to be reduced so much, that we were working against a Gramm-Rudman-Hollings sequester that in the year we are in would have cut $7.5 billion in outlays more than we agreed to in the summit; and I do not know what the number would have been for 1989 when we finished the process up here. But we got a fixed floor and ceiling in both budget authority and outlays, and as I understand it, your budget seeks to live within that, and I commend you for it.

Now, having said that, using the same approach to defense that we use in domestic spending, I think it also should be said that this will now be the fourth year in a row when the programmatic authority of the U.S. Department of Defense has been cut in terms of real growth, the fourth year in a row—not increased, but cut.

Now, I understand that that is how we measure domestic programs. A reduction from inflation is a cut. And for the fourth year in a row, you have had to do that in defense, with at least one of those years being almost a zero—no growth, nominal or otherwise.

It has been very difficult, as I understand it, in the ups and downs of the last 6 or 7 years, and I hope you will explain the effect of that to us today. If you are not prepared to, I am sure some of us will ask you what that has meant, and if you have any ideas on how we might do better.

I am going to comment very briefly on this notion of burdensharing. I don't like the words, but nonetheless they seem to express the relationship of our allies and ourselves to paying for the defense of the free world against the Soviet threat.

I think, Mr. Secretry and Admiral Crowe, the issue is not whether that is going to happen. I believe for economic reasons it is going to have to happen in the next decade. But I think the issue is how we get it done; how do we get it done and maintain a strong, cooperative, reliable set of alliances against the Soviet Union.

It well have to be done, and the Japanese are going to have to bear some additional defense burden in the free world. I am not sure how we do that, either, and I think the question is, not if they should, but how?

My last comment has to do with procurement of weapons systems. I hope you will discuss with us today how we might get more for our dollar if we are willing to accommodate to some new concepts, because I believe it is time we think about that. I believe we can get much more for our dollar if we will set in place some procurement mechanisms that permit that to be done on multiyear basis, in many, many respects and across many procurement lines. I hope you will address that.

With reference to your request for increased transfer authority, I hope you will address the outlay implications of that, because I think we all want to live within the ceilings that we agreed upon.

Thank you, Mr. Chairman.

Chairman CHILES. Thank you, sir.

Mr. Secretary.

STATEMENT OF HON. FRANK C. CARLUCCI, SECRETARY OF DEFENSE

Secretary CARLUCCI. Thank you very much, Mr. Chairman.

Mr. Chairman, at the outset let me express my admiration for the job you have done in your years in the Congress and the leadership you have exercised, not only in this committee but elsewhere in the Congress. I have enjoyed working with you, and you will be missed. I appreciate this opportunity for Admiral Crowe and for me to appear before this committee.

Mr. Chairman, I have a rather lengthy statement, which I would ask be included in the record.

Chairman CHILES. Your statement in full will be included in the record.[1]

Secretary CARLUCCI. And I will summarize.

As Senator Domenici indicated, the budget that we are submitting fits within the four corners of the summit agreement as both the ceiling and the flloor.

I need to tell you that I am personally uncomfortable with the national security risks encompassed in this budget, and we have made an effort to minimize those risks by constructing a balanced budget.

Our priorities have been very simple and straightforward. They are: Quality personnel; readiness; and efficient acquisition. To maintain those priorities in the face a real decline of 0.7 percent, we have had to cut, and we have elected to make the cuts in force structure and in weapon systems in various stages of development or procurement.

Let me review with you quickly the programs that we have protected.

We will continue in fiscal year 1989 the training levels originally planned, and those equal to or which exceed the straining levels in 1988.

---

[1] See p. 73.

We propose a military pay raise equal to our original fiscal year 1988–89 request—that is, 4.3 percent.

Let me say, Mr. Chairman and members of the committee, that we feel strongly about the pay raise. It fits with our first priority, quality people. Never have we had better in our military. Never have we had a better record of recruitment and retention. And the time to worry about that record is now, when we find comparability lagging some 11 percent behind the private sector. We do not want to repeat the experience of the 1970s, where we tell our people we only value them when they start to leave, and then have to run to catch up with a gigantic catch-up pay raise.

So we feel very strongly that the 4.3 percent is needed to maintain the quality of the force, and we have elected to have a smaller force to accommodate the funding for this pay raise.

We will continue to fund added stocks of munitions aggressively. We propose 1989 levels at or near those enacted in fiscal year 1988.

We will continue production of key systems at or near the rates originally planned. The conventional systems specifically include the M–1 tank, the Bradley Fighting Vehicle, the V–22 tilt rotor aircraft, the new SSN–21 submarine, the F–14, FA–18 and F–16 programs.

Strategic systems include the Trident submarine and missile programs.

And while we will continue to pursue rail garrison basing for Peacekeeper, we are limiting the fiscal year 1989 missile request to 12, in view of the repeated congressional reluctance to provide funds for a larger number.

Let me say a word about Peacekeeper, Mr. Chairman. I am firmly of the view that this country needs a mobile system. Pursuant to the authority that we have from the Congress, we are currently putting some 50 Peacekeeper missiles in fixed silos; some 34 are already in silos. We have a total of some 78 missiles, when you consider those missiles that are used for operational testing, aging and surveillance.

As we move forward in the development stage with rail garrison, I would urge that we continue to purchase Peacekeeper missiles. We find that the number 12 is the maximum Congress seems to allow us, and while we would like more, we have settled for 12 in this year's budget. Those would be put into the pool that we have for testing, aging and surveillance, and as soon as the Congress approves the rail garrison mode, we would begin to put some of those missiles on rail garrison. We then intend to ask the Congress for some 50 additional missiles which would be on rail garrison, and as rail garrison comes on line, we would take the new missiles, those that we have in the existing pool, and those that are in the fixed silos, and move them to the rail garrison mode, eventually, I would hope, giving us a force of 100 MX missiles on rail garrison, or 1,000 warheads.

At one point, in one of my statements, it was stated that 8 of the 12 we are requesting would be put on rail garrison. I have corrected that. That has never been part of my testimony. I have testified consistently that the 12 we want this year would be put in the pool and made available for rail garrison once we and the Congress agree on rail garrison.

Rail garrison is our decided preference for MX basing. Force structure has been eliminated and we will eliminate some 450 Army helicopters in 1988 and 370 more in 1989; eliminate one active Army brigade; elements of another will not be activated as planned. We will decommission two active Air Force tactical fighter wings, and the equivalent of another in the reserves. We will decommission one active naval air wing, leaving 13 active air wings. This, coupled with the two reserve air wings, will give us enough aircraft for our 15-carrier battle groups.

We will decommission one ballistic missile submarine and 16 Navy frigates. The decommissioning of these frigates, coupled with the late deliveries, means that we will not achieve the 600-ship Navy goal in fiscal year 1989; indeed, we would not have achieved it anyway, due to late deliveries. We will have 580 ships, maybe, in 1989. A 600-ship Navy continues to be a goal, but that will have to be achieved sometime in the 1990s.

With these changes, we will be eliminating approximately 110,000 active and reserve military and civilian positions from planned fiscal year 1989 levels. Actual numbers reduced, that is to say, off the fiscal year 1987 actuals, is about 45,000. Of that, some 36,000 are active duty military, and that is offset by an increase of 22,000 in the reserves, leaving a net of 14,000. And then there will be layoffs of approximately 31,000 on the civilian side, giving us a total of 45,000.

In terms of programs terminated or significantly altered, the two largest are the Navy's A-6F program—and we are looking at a form of remanufacturing in that program—and the Air Force's small ICBM missiles, the so-called Midgetman.

This is a decision driven principally by budget constraints. I believe our country can no longer afford two land-based systems, given realistic budget projections. Based on our analysis, the rail garrison system is far more cost-effective. We can complete the 1,000 warheads that I mentioned earlier for rail garrison for a cost of $17 billion. The life cycle cost for 500 Midgetman warheads is $39 billion.

Now, we hear a lot of argument about strategic versus tactical warning. I am prepared to concede there are some marginal advantages to Midgetman if you believe in the bolt out of the blue. After years in the intelligence business, I do not believe in the bolt out of the blue. I think we are bound to get some warning, and we can generate the MX rail garrison force in a matter of hours, 5 or 6 hours. So the marginal advantage of Midgetman is very small, indeed, in that area. Once the force is generated, it is, in my judgment and in the judgment of the Air Force, just as invulnerable as Midgetman. We have some 200,000 miles of railroad in this country, and we can certainly generate the rail garrison missile in such a way that the enemy would have to barrage it, and that is the essential goal of any mobile force.

Nonetheless, in the interest of preserving what has come to be known as a strategic consensus on the Hill, I have agreed to put $200 million into funding for Midgetman this year, to keep the program going, in order to allow my successor and the President's successor to wrap it up again, should they see fit to do so and should the resources be found—but I quite frankly doubt that the resources will be available.

The Army's light helicopter program is being restructured and will be refocused on a narrow mission, armed reconnaissance. The attack missions and the transport missions will be picked up by the Apache and the Blackhawk, respectively.

We have cancelled the ASAT program, and Mr. Chairman and members of the committee, we have not done this willingly. For 3 years, the Congress has refused us the authority to test that program. We think we need a deterrent in the ASAT area. The Soviets have an operational system. But any system, if it is not tested, begins to degrade, and we lose confidence in that system. And, in a period of budget constraint, I cannot justify putting scarce resources into a program that we cannot test. Therefore, I have not requested funding for the ASAT program.

Should the Congress change its mind, I would be glad to try and identify some offsets to go ahead with that program, because Admiral Crowe and I are in thorough agreement that this is a vitally important capability for us to have.

These and other procurement actions, which I will not detail here, will give us savings of about $5 billion in 1989, long-term savings of about $50 billion.

In terms of budget shares, O and M rises. That fits with our readiness priority. Military construction and family housing will rise. The procurement account goes down by over 5 percent. RDT&E and military personnel remain about the same.

The result, Mr. Chairman, is a smaller force, but a force whose readiness, quality of people, sustainability and modern equipment could well turn out to be the best we have had in a long time. In short, it is the sort of force we started out to build in 1981, but smaller.

Let me touch on a couple of special issues. You mentioned in your opening statement, Mr. Chairman, burdensharing. I share the view that we need to urge our allies to do more. Indeed, I have urged them to do more—all members of the administration have urged them to do more.

On the other hand, it is fair to say that they are doing more than is commonly recognized. I think we need to approach the burdensharing undertaking as an effort to strengthen the alliance, not as an effort to solve our budget problem. If we go to the allies and say we have been obliged to cut our budget, and therefore you have to make up for our budget cuts, I predict a lack of success.

On the other hand, if we exercise leadership and promote the kinds of things that you mentioned in your statement, Mr. Chairman—co-production of weapons systems, interoperability, looking at the kinds of missions that we can conduct, out-of-area responsibilities, moving ahead more vigorously on the conventional defense initiatives which establish force goals, trying to get the allies to do more in the area of bringing their sustainability up—those kinds of things, then I think we can move in a positive direction, and I am more than happy to work with the Congress in this area.

Senator Domenici, I believe you mentioned acquisition. This is an area in which, as you are probably aware, I have a strong interest. We are trying to take somewhat of a new approach in this last year, and I hope that we will have time, working with the Congress, to make it stick.

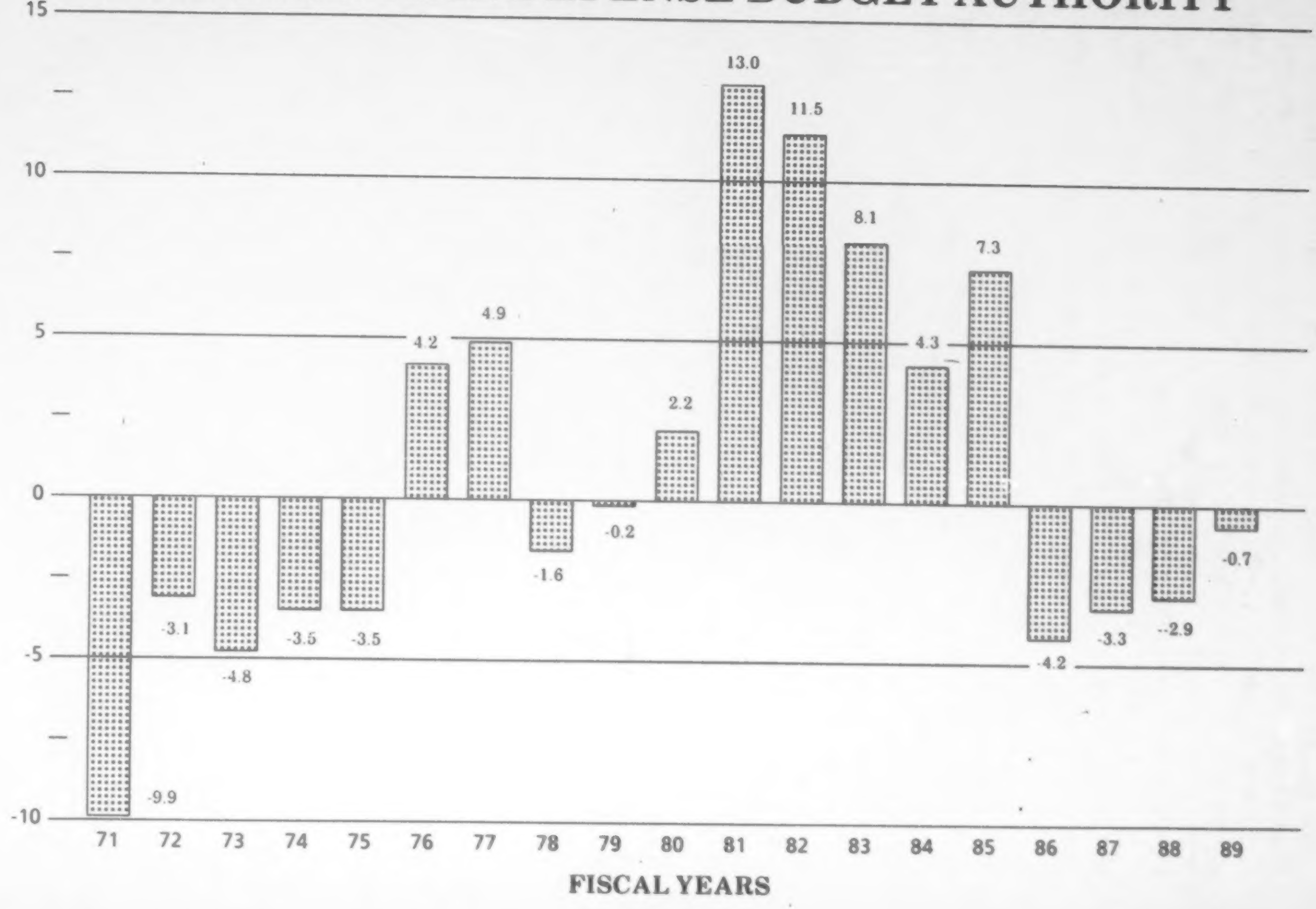
We are really talking about trying to change the climate in which we build weapons systems, and to base our approach on the concept of quality—quality built in right from the outset, not quality that is examined once the product comes off the production line, but quality that is built into the requirements, quality that is built into the manufacturing process. Some 40 percent of the life cycle costs of a weapons system are in the logistics tail. If we have quality guaranteed at the outset, we can eliminate a substantial portion of those costs.

We are also beginning to focus on the 95 percent of the procurement equation that is cost, instead of just looking at the 5 percent that is profit. And here, we have to work cooperatively with the Congress and the defense industry, and we must look upon that industry as a national asset. We have to encourage productivity investments in that industry.

And if we work with industry to get at that cost base, I am convinced that we can achieve substantial savings. We need to clear away some of the underbrush to do this, and we need to create somewhat of a new climate.

But there is one absolute fundamental if we are going to achieve savings in the $80 billion procurement account, and I would recommend that we work on that account to try and achieve savings. And that is to build stability into the defense budgeting process. Mr. Chairman, here is a chart that shows you what has happened to defense budget authority since 1971, and you can see the sawtooth nature of the funding for our national defense.

REAL GROWTH IN DEFENSE BUDGET AUTHORITY



Secretary **Carlucci**. Quite frankly, Mr. Chairman, it is impossible to manage a $300 billion department sensibly that way, particularly when, on the average, the defense dollar takes 3 or 4 years to spend out. You don't know how much money you are going to have from year to year. Your contractors cannot plan their work force; they cannot plan the long lead items.

Now, I accept the fact that we are in a period of budget constraint. I have lowered the outyear estimates from 5 percent to 2 percent. And I would gladly trade off some increases for budget stability.

We have another chart here which shows you that, had we just had zero——

Senator **Domenici**. Mr. Chairman, might I ask is that all of defense, or merely the procurement account?

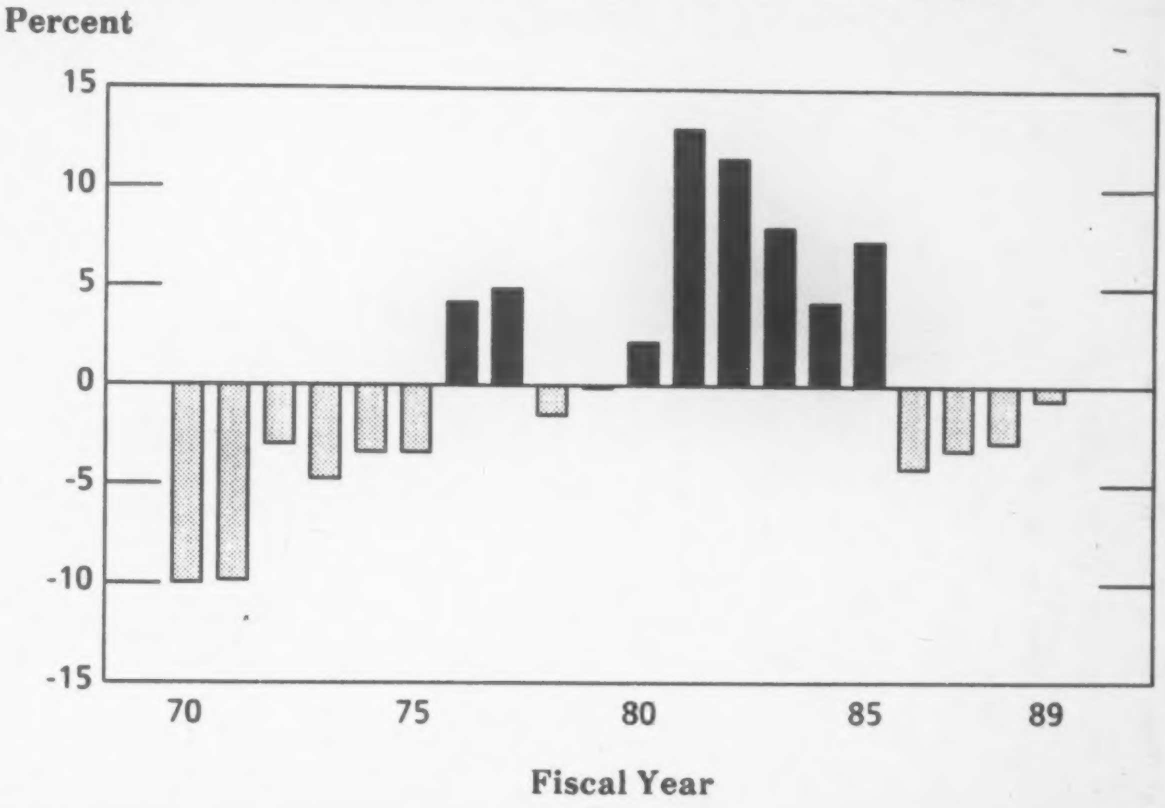
Secretary **Carlucci**. No; that is all of defense, Senator.

Senator **Domenici**. All right.

Secretary **Carlucci**. We could develop the same kind of chart for the procurement account, and you would see the ups and down.

But here, you can see that had we just had a zero percent growth line since 1970, we would be just as well off as we are today, with the ups and downs in the defense budget. So if there is any thought I would leave you with, it is that we need to find a way to build some stability into this process. The authorizing committees are already looking at a 2-year budget. Maybe, Senator Domenici, we want to break out the procurement budget and put it on a more long-range funding basis.

REAL GROWTH IN DEFENSE BUDGET AUTHORITY



Secretary **Carlucci**. Anyway, if the committee thinks it feasible, I would be prepared to work with you, because I can assure you that there are savings there, if we can build some stability into the process.

That completes my opening statement.

Chairman **Chiles**. Thank you, sir.

[The prepared statement of Secretary Carlucci follows:]

STATEMENT OF THE SECRETARY OF DEFENSE FRANK C. CARLUCCI

BEFORE THE SENATE BUDGET COMMITTEE

IN CONNECTION WITH THE AMENDED FISCAL YEAR 1989 BUDGET FOR THE DEPARTMENT OF DEFENSE

MARCH 3, 1988

Mr. Chairman, Members of the Committee:

The Department of Defense submitted a biennial FY 1988/FY 1989 defense budget just a year ago. That program reflected Secretary Weinberger's commitment to continuing the rebuilding of U.S. defense capability, a commitment which I share. That integrated two-year program was deemed not affordable by the Congress and ultimately rejected. As a result of the budget summit agreement, the FY 1988 program was reduced by $20 billion and the Department was directed to revise the FY 1989 request to cut $33 billion in budget authority and $18 billion in outlays. Thus, including the $20 billion the Administration has already reduced from the original FY 1989 fiscal guidance, the amended budget reflects a program adjustment of over $50 billion.

Tough choices had to be made to accommodate this reduction in the short time available. Priorities had to be set. Gains already made had to be protected. My guidance to the Department was that I would choose a smaller force that was fully ready to perform its mission as opposed to a large force that was not ready. The priorities in this budget were straightforward--people, readiness and efficient acquisition. This budget proposes the compensation and quality of life required to attract and retain the best caliber people for the military. Critical readiness and training activities are funded to the maximum ability of the Services to execute them. Cost effective acquisition has been stressed with a special injunction not to tolerate program stretches as a convenient but inefficient tool for dealing with reduced resources. To the extent practical, this defense budget attempts to maintain economic production rates for major procurement programs.

These priorities have been financed with fewer resources by accepting end-strength reductions, retirement of force structure, program terminations and deferrals and a flat R&D effort. These have been unpopular choices and I would rather not have had to make them, but we owe it to our fighting men and women to do our best by them even in times of austerity. I believe these choices to be not in the best interest of our national security posture. However, I have made them. They reflect the fiscal realities we face today and my assessment of the direction which affordability considerations will have to take our posture in the future. I hope the Congress will agree with me on this very fundamental point.

Before I elaborate on the details of the FY 1989 amended budget, I should note three factors which were critical to being able to deal with the budget summit mandated defense reduction of $33 billion which had to be developed in little more than five working weeks. The first factor was that the Department of Defense has already provided the Congress a biennial budget last year. The FY 1989 program contained in that submission was the baseline for what you have before you now. You have seen it all before in full detail--but $33 billion is missing now. The second factor was that the budget summit agreement gave the President a firm defense topline commitment in advance. My belief is that the political question of defense budget topline allocation has been made. I have counted on the political stability of that topline as decisions of program priorities have been made by the Department. Mr. Chairman, I urge this committee and the entire Congress to protect stability. Finally, it is my belief that only the Department's cadre of civilian and military leaders and their staffs could have managed a program readjustment of this size and complexity in so short a time. Deputy Secretary of Defense Will Taft's leadership was excellent in this process and resulted in my being able to present the Department's budget to you today.

Mr. Chairman, the Administration will honor the budget summit agreement on defense spending. I must remind you that the summit figures for defense continue the downward trend, in real terms, of the last 3 years. The consequence of this decline, should it continue, will be the erosion of the improved capabilities we have purchased in the early 1980s and a requirement to purchase it again at much higher cost in the future.

A topline of $299.5 billion in budget authority for national defense does not fully finance our requirements, given the commitments and threats we face. This gap between available resources and program requirements represents the level of risk we must assume in our defense strategy. Accommodating the FY 1989 $33 billion reduction very simply dictates acceptance of higher levels of risk.

DEFENSE PRIORITIES

- **QUALITY PERSONNEL**
- **READINESS**
- **EFFICIENT ACQUISITION**

As this budget was amended, I was determined to prioritize and protect specific critical areas of the defense program. Particularly, I sought to preserve the gains achieved in readiness; to continue support for an optimum force structure and manpower level, including fair and adequate pay and benefit levels so crucial to morale and retention; and to finance an efficient acquisition process. Simply put, the priorities reflected in this budget are people, training, and no artificial program stretches.

To ensure sufficient funding for these priorities within a topline reduced by $33 billion, it was essential to regard force structure, marginally capable systems, programs experiencing technical problems, low priority programs and new starts as candidates for reduction and termination. Even as we confront constrained defense resources, I am determined to minimize the erosion of our military capabilities in the face of a threat environment that has not diminished. The force structure may have to be smaller, but it will continue to be well manned, equipped and trained As you review this budget, I hope you will support these decisions and recognize that even those that appear unpalatable are necessary to maintain an essential balance in defense capability.

Defense Strategy

The overall defense strategy of the United States and its allies is that of deterrence. We seek to deter aggression by making the penalties of such action exceed expected gains. Integral to deterrence is the assurance that the United States possesses both the means and the will to respond effectively to aggression regardless of its form.

Since the beginning of the nuclear era, our deterrence has been based on the threat of nuclear retaliation against those who would employ nuclear forces against us or our allies. At the same time, efforts to develop a defense against nuclear attack played an important role in post-war strategy until the late 1960s when interest in this concept was dampened by the rapid buildup of Soviet nuclear forces and the lack of progress on technologies for strategic defenses in the United States.

It was not until the Reagan Administration in the early 1980s that a priority was again placed on strategic defenses. In 1983, President Reagan announced the Strategic Defense Initiative (SDI) intended to determine the feasibility of deploying an effective defense against nuclear ballistic missiles. The progress being made in this area may provide the option to begin deploying the first phase as early as the mid- to late-1990s. We should remember that, for over a generation, the Soviets also have been investing heavily in strategic and other passive defenses.

In spite of our optimism for the successful development of an effective strategic defense system and the possibility of deep reductions in offensive strategic nuclear forces, it is still critical that we maintain our nuclear deterrent and strong conventional forces. The recent successful INF negotiations demonstrate the importance of our commitment to maintaining and modernizing effective nuclear and conventional forces as an incentive for real arms reductions. We remain committed to the continued modernization of our strategic nuclear forces even as we pursue success at the Strategic Arms Reductions Talks (START).

Conventional forces are the most likely to be actively and visibly protecting our interests on a day-to-day basis. From our forces in the Persian Gulf to our forward-deployed forces in the Republic of Korea and NATO, U.S. general purpose forces, under the umbrella of a secure nuclear deterrent, are essential to the deterrence of war on the middle and high end of the conflict spectrum. Although structured primarily to counter the Soviet threat, conventional forces must be prepared to deter or combat aggression at the lower end of the spectrum. It is in the low-intensity conflict environment that our general purpose forces have found themselves most actively engaged over the past thirty-five years.

Because low-intensity conflict is and will continue to be a major threat to our security and interests around the world, I am committed to the revitalization and reorganization of our Special Operations Forces (SOF) within the Department of Defense. FY 1989 is a critical year in our revitalization efforts, both in terms of the delivery of previously funded systems and new initiatives. We have institutionalized SOF within the Department through the creation of the U.S. Special Operations Command (USSOCOM), the establishment of an Assistant Secretary of Defense for Special Operations and Low-Intensity Conflict and the creation of a Major Force Program for SOF within our Five-Year Defense Program (FYDP). As we complete our efforts to integrate SOF into the overall defense structure, I urge your continued support in sustaining SOF capabilities into the 1990s.

We are determined to continue modernization and development efforts so critical to our strategy. While the budget summit level is insufficient to maintain the defense envisioned a year ago, we recognize the economic and political realities that have resulted in this lower defense funding and have adjusted our defense program within that level. If, however, I find that our national security needs require additional resources, I will not hesitate to present my assessment of the military/political situation and seek your support.

Budget Overview

The FY 1988/FY 1989 budget submitted for the Department of Defense last year represented a serious effort to introduce stability and consistency to defense funding. Had it been enacted, that two year budget would have afforded the Department significant opportunities to realize savings and other benefits from assured procurement quantities and approved levels of management effort. Unfortunately, the Congress did not provide a two year authorization and appropriation. Nevertheless, I intend to continue biennial budgeting in the Department of Defense and the President will submit an FY 1990/FY 1991 biennial budget a year from now. Biennial budgeting is now a fully institutionalized phenomenon in the Department of Defense. I urge the Congress to adopt the same procedure. Until that happens, the Department will continually be in the position of doing the second year's budget twice.

NATIONAL DEFENSE TOPLINE
(Current $ Billions)

	1988	1989	1990	1991	1992	1993
BUDGET AUTHORITY						
DoD	283.2	290.8	307.3	324.3	342.0	360.3
DoE & Other	8.2	8.7	9.1	9.4	9.6	9.9
TOTAL 050	**291.4**	**299.5**	**316.4**	**333.7**	**351.6**	**370.2**
OUTLAYS						
DoD	277.3	285.5	297.3	311.0	325.9	341.5
DoE & Other	8.1	8.5	8.9	9.2	9.5	9.8
TOTAL 050	**285.4**	**294.0**	**306.2**	**320.2**	**335.4**	**351.3**

The amended Department of Defense budget request for FY 1989 conforms with the budget summit agreement allocations for national defense of $299.5 billion in budget authority and $294 billion in outlays. The Pentagon's portion of this budget authority figure is $290.8 billion; $32.5 billion lower than the funds requested for FY 1989 in last year's submission. The balance of the $299.5 billion is allocated to the Department of Energy's nuclear weapon activities and other related national security activities. The FY 1988 budget of $283.2 billion enacted by the Congress was $20.1 billion lower than the President's request.

FY 1989 AMENDED BUDGET
BUDGET AUTHORITY BY MILITARY COMPONENT
(Current $ Billions)

	FY 1989 Request	FY 1989 Amendment	FY 1989 Revised	FY 1989 Real Growth
ARMY	84.7	-6.9	77.8	-0.7
NAVY	108.7	-12.3	96.4	-6.8
AIR FORCE	107.2	-10.0	97.2	6.6
DEFENSE AGENCIES	20.9	-2.6	18.3	5.6
DEFENSE WIDE	1.7	-0.7	1.0	-
TOTAL	**323.3**	**-32.5**	**290.8**	**-0.7**

The amended budget continues to reflect a balanced program among the Military Departments with the relative shares of the budget remaining essentially constant. The Navy reflects a lower level of budget authority in FY 1989 than in FY 1988 principally because the approved FY 1988 program fully-funded two aircraft carriers. Severe cuts in FY 1988 led to the Air Force increase in FY 1989 budget authority.

FY 1988 DoD BUDGET
BUDGET AUTHORITY BY TITLE
(Current $ Billions)

	FY 1988 Request	Congressional Action	FY 1988 Enacted	FY 1988 Real Growth
MILITARY PERSONNEL	78.3	-2.2	76.1	-0.3
OPERATION & MAINTENANCE	86.6	-5.9	80.7	-4.8
PROCUREMENT	84.0	-3.0	81.0	-2.5
R D T & E	43.7	-7.0	36.7	-1.0
MILITARY CONSTRUCTION - FAMILY HOUSING	10.1	-1.6	8.5	0.0
OTHER	0.6	-0.4	0.2	-
TOTAL	**303.3**	**-20.1**	**283.2**	**-2.9**

FY 1989 AMENDED BUDGET
BUDGET AUTHORITY BY TITLE
(Current $ Billions)

	FY 1989 Request	FY 1989 Amendment	FY 1989 Revised	FY 1989 Real Growth
MILITARY PERSONNEL	81.6	-3.2	78.4	-0.2
OPERATION & MAINTENANCE	91.5	-5.9	85.6	2.4
PROCUREMENT	94.6	-14.5	80.0	-4.3
R D T & E	44.3	-6.2	38.2	0.3
MILITARY CONSTRUCTION - FAMILY HOUSING	10.7	-1.7	9.0	2.5
OTHER	0.6	-1.0	-0.4	-
TOTAL	**323.3**	**-32.5**	**290.8**	**-0.7**

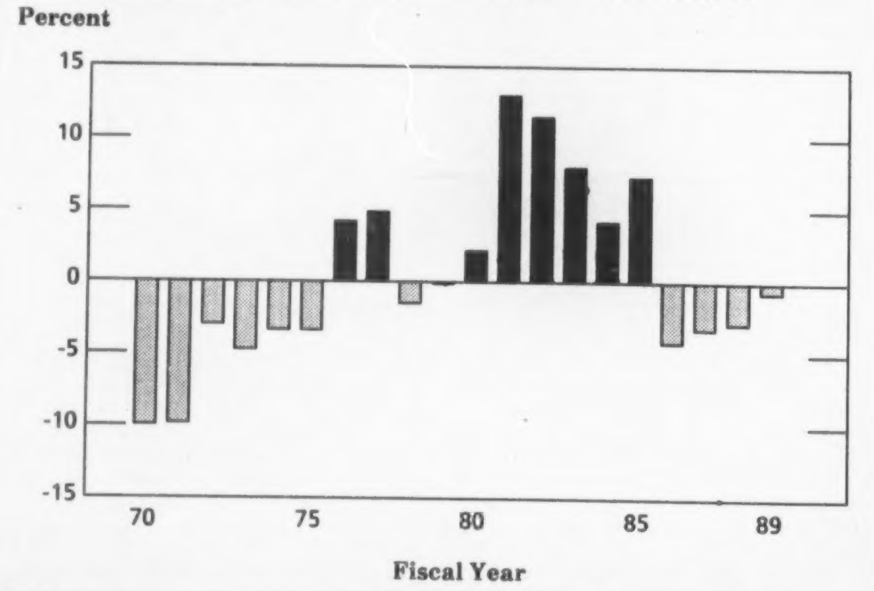
This two-year reduction of over $52 billion to the planned defense program forced difficult choices among defense priorities. In real terms, the FY 1989 budget represents a real decline of about 1 percent--the first time in 15 years that a defense request is negative--and follows three years of real decline after congressional action. In the Military Personnel accounts, the Department has sought to preserve the significant gains experienced in recruiting and retention. The Operation and Maintenance and Military Construction titles are the only areas with real increases over FY 1988, which underscores the Department's concern about readiness and resolve not to allow a return to the poor state of readiness that existed in the 1970s. Procurement accounts have incurred the largest reductions since 1985. Eighteen existing development or procurement programs will be terminated in the amended budget. Also, this budget cannot afford to fund some previously planned new starts in research and development. This is of concern to the Department because the U.S. has been able to counter numerical superiority of Soviet weapons with more sophisticated technology. We cannot afford a trend that allows the development of weapons for tomorrow's force to be neglected.

FY 1989 AMENDED DoD BUDGET
BUDGET AUTHORITY & OUTLAYS
(Current $ Billions)

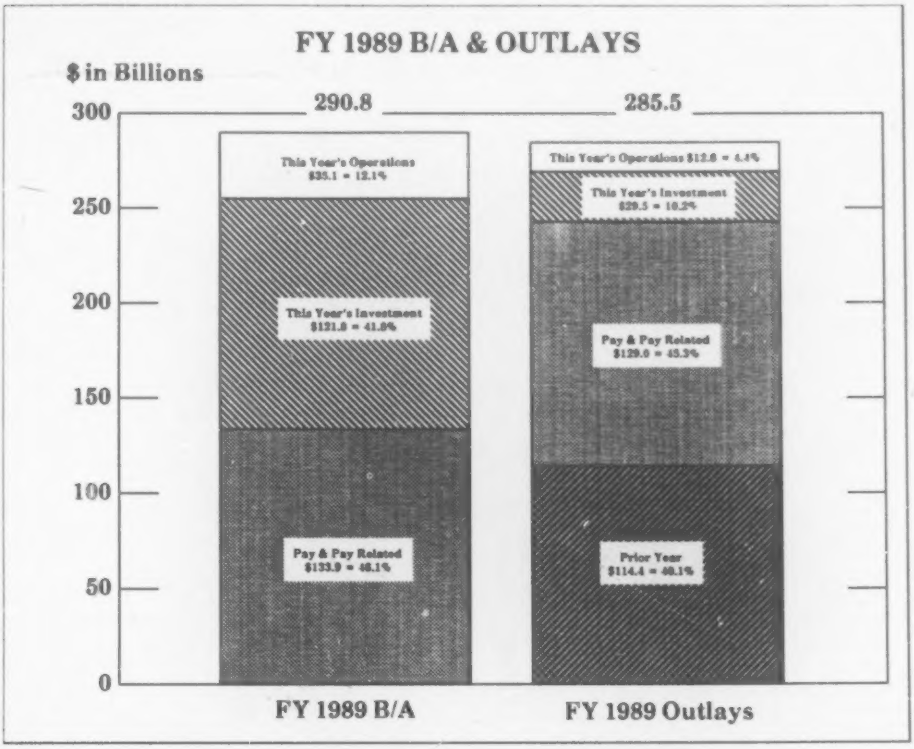
	FY 1986	FY 1987	FY 1988	FY 1989
BUDGET AUTHORITY	281.4	279.5	283.2	290.8
% Real Growth	-4.2%	-3.3%	-2.9%	-0.7%
OUTLAYS	265.6	274.0	277.3	285.5

Department of Defense outlays in FY 1988 are projected to be $277.3 billion, a level $12 billion lower than projected last year. Outlays in FY 1989 are projected to be $285.5 billion, a level $18.2 billion lower that projected last year. These outlay levels are consistent with the summit agreement.

REAL GROWTH IN DEFENSE BUDGET AUTHORITY



Mr. Chairman, it is instructive to reflect back upon the 1970s because then, as now, economic and political concerns determined the allocation of resources to the Department of Defense rather than national security needs. The results were unfortunate, not only for the condition of our military forces, but for the perception of our country held by other nations. Likewise, the price we paid in the early 1980s to reverse the previous decline was high. Still, the result of that large investment was a dramatic reversal in our military capabilities. Not only were more resources allocated to defense but, because of an intensive internal program of acquisition reform, those resources were more effectively employed. Further, program and budget formulation have benefitted tremendously from increased participation by the Joint Chiefs of Staff and the Unified and Specified Commanders in these processes. However, with four years of real decline in defense already a fact, I fear we are already halfway into another decade of neglect without even realizing it. We must stop this downward funding spiral.



The distribution of FY 1989 budget authority reflects the historical balance between people, readiness and modernization. Of the $290.8 billion requested for the Department of Defense, roughly 12 percent represents costs associated with day-to-day operations, nearly 42 percent represents investment in research, development and procurement of weapons and equipment and over 46 percent is associated with civilian and military pay and related military personnel expenses.

While new investment represents 42 percent of total budget authority requested, it represents only 10 percent of projected FY 1989 outlays. The nature of defense investment is such that production or construction occurs over a period of years with dollars disbursed as work is accomplished. As a result, 40 percent of projected FY 1989 outlays are associated with prior year commitments - ships, weapons, missiles, aircraft that are in the pipeline. It is this very fact that makes tailoring the defense budget to meet reduced outlay targets, as the budget summit requires, so difficult.

Force Structure Changes

ARMY FORCE STRUCTURE CHANGES
($ in Millions)

	Changes	
	Dollars	Manpower
•• Deactivate one Active Brigade of the 9th ID (Motorized) at Fort Lewis, Washington.	- 156	-3,133
•• Cancel planned FY 1989 Activation of two 6th ID (L) Battalions in Alaska.	- 72	-1,411
•• Deactivate the Army National Guard ROLAND unit in New Mexico.	- 38	-
•• Retire 170 OH-58/UH-1 Scout Aircraft	- 3	-
•• Retire 450 OH-58/UH-1 Utility Aircraft	- 119	-2,200
•• Reduce Administrative Support Personnel	- 132	-3,603
•• Reduce Temporary Civilian Hires at Logistic and Supply Operations	- 40	-
•• Reduce Civilian and Selected Reserves Strength	- 558	-36,569
TOTAL ARMY SAVINGS	- 1,118	-46,916

Significant force structure and program changes have been proposed that affect the near- and long-term risks associated with implementing national security policies. The budget reflects 18 active and 10 reserve component divisions in the Army and 3 active and 1 reserve divisions in the Marine Corps, the same as last year. Army active military end strength will be reduced by 8,600 soldiers compared to the original FY 1989 Department of Defense request. By the end of FY 1989 the Army will deactivate one brigade from the 9th Motorized Infantry Division at Fort Lewis, Washington, reduce the size of some helicopter units and reduce supporting headquarters personnel throughout the Army. Planned activation of the 6th Light Infantry battalion in Alaska will not occur in FY 1988 and FY 1989.

The Army aviation fleet will be reduced from more than 8,200 aircraft to less than 7,000 aircraft by eliminating 450 OH-58A and UH-1 helicopters by the end of this year, 170 helicopters in FY 1989 and another 742 over the next five years. The resulting fleet will be smaller but equipped on the average with newer and more capable aircraft.

Achievement in FY 1989 of the Navy's long-standing overall force goal of 600 ships has had to be deferred in order to allocate adequate funds to support fully a smaller force structure. The Navy will decommission one SSBN originally scheduled for overhaul. Fiscal constraints resulted in the proposed retirement of 16 frigates. These actions, along with other program adjustments such as the congressionally directed retirement of an SSBN in FY 1988, will result in an overall force of 580 deployable battle force ships at the end of FY 1989. The Navy will have to stand down the 14th carrier air wing, relying instead on the two reserve carrier air wings to support ship deployments. Navy active force military end strength will be reduced by 9,600 from the original FY 1989 plan. Marine Corps' actual end strength will be reduced by 2,900 active Marines and 900 reserve Marines by restructuring combat units.

NAVY FORCE STRUCTURE CHANGES
($ in Millions)

	Changes	
	Dollars	Manpower
•• Retire 16 Frigates in FY 1988/FY 1989.	- 166	-4,400
•• Will not stand up the 14th Air Wing at Miramar Naval Air Station.	- 95	-1,600
•• Deactivate one Strategic Submarine.	- 116	-11
•• Decrease the Navy, Marine Corps and Navy Reserve Military, and Civilian End Strength.	- 372	-22,322
TOTAL NAVY SAVINGS	- 749	-28,333

The Air Force will begin deactivation of two tactical fighter wings in FY 1989; the 474th at Nellis Air Force Base, Nevada, and the 401st at Torrejon Air Base in Spain. If we are successful in our efforts to locate a new base for the 401st in Europe and we are making progress, we will nominate another wing for deactivation. The 401st is vitally important for NATO's deterrent. By the end of 1990, additional aircraft in several different U.S.-based Air Reserve Force squadrons, equal to a third wing, are planned for elimination, which will reduce the total Air Force tactical fighter wing equivalents to about 35 from the current level of nearly 38. The Air Force also will begin the phase-out of SR-71 aircraft as well as two helicopter-equipped tactical air support squadrons. Total active Air Force military personnel end strength will be reduced by 25,000 compared to the original FY 1989 defense request.

AIR FORCE FORCE STRUCTURE CHANGES
($ in Millions)

	Changes	
	Dollars	Manpower
•• Deactivate the 401st Air Wing in Spain.	- 15	-735
•• Deactivate the 474th Tactical Fighter Wing at Nellis AFB.	+ 57	-
•• Reduce SR-71 Program in FY 1989.	- 119	-527
•• Reduce 12 Guard and Reserve Tactical Fighter Squadrons from 24 to 18 Aircraft by end FY 1991.	- 5	-174
•• Deactivate two helicopter Equipped Tactical Air Support Squadrons.	- 4	-249
•• Convert an Air Guard RF-4C Recon. Squadron to a C-130 Tactical Airlift Squadron.	+ 5	-
•• Reduce Vandenberg to Mothball Status.	- 12	-
•• Reduce Military, Civilian, and Selected Reserve Strength.	- 533	-30,528
TOTAL AIR FORCE SAVINGS	- 626	-32,213

Program Adjustments

ARMY PROGRAM TERMINATIONS
(Current $ Millions)

	FY 1989	FY 1989 & BEYOND
AQUILA RPV	226	1,096
Anti-Tactical Missile	35	149
EH-60 Helicopter	45	45
Howitzer, M198	20	91
Mortar, 120mm	24	161
Copperhead	106	747
TOTAL	455	2,289

NAVY PROGRAM TERMINATIONS
(Current $ Millions)

	FY 1989	FY 1989 & BEYOND
A-6F Aircraft	918	5,655
Naval Airship	62	135
Anti-Radiation Seeker	8	109
High Frequency Anti-Jam (HFAJ) Radio	52	87
5 Inch SAL GP	*	*
Skipper	37	209
TOTAL	1,077	6,194

* Not included in Original Biennial request

AIR FORCE PROGRAM TERMINATIONS
(Current $ Millions)

	FY 1989	FY 1989 & BEYOND
ASAT	786	2,218
Small ICBM *	2,150	39,790
Minuteman III PenAids	129	561
C-27 Aircraft	65	65
AGM-130	92	401
Airborne Command Post Replacement	14	140
TOTAL	3,237	43,175

* Budget includes $200 Million to protect the option of the next Administration.

Eighteen development and procurement programs are terminated in the amended budget, which will reduce FY 1989 funding requirements by nearly $4.8 billion and save another $46.9 billion in the outyears.

Programs were terminated for a variety of reasons. Some were cancelled because they were not affordable, such as the Army's AQUILA Remotely Piloted Vehicle (RPV), Copperhead projectile, and the 120mm mortar; the Navy's High Frequency Anti-Jam (HFAJ) Radio, Naval Airship, Skipper bomb, and 5" Guided Projectile; and the Air Force's Minuteman III Penetration Aids and Airborne Command Post System Replacement. Others were terminated because there are viable alternatives that satisfy mission requirements. The Army will upgrade the Patriot Missile in lieu of procuring the Anti-Tactical Missile; the Navy will upgrade the A-6E rather than produce the A-6F; and the Air Force will use existing chartered aircraft and cancel production plans for the C-27 aircraft. The Army terminated the M198 Howitzer and EH-60 helicopter since present forces will provide an acceptable capability. The ASAT missile program was cancelled due to continual congressional testing restrictions that preclude the benefits of further investment. Finally. the Air Force cancelled procurement of the AGM-130 powered GBU-15 because of technical problems.

ARMY PROGRAM DEFERRALS
(Current $ Millions)

	RDT&E	PROCUREMENT	TOTAL
Forward Area Air Defense C^2I	65	63	128
Advanced Anti-Armor Weapon-Heavy	92	-	92
Armored Family of Vehicles	45	-	45
LHX Helicopter Restructure	407	-	407
Army Data Distribution System	-	85	85
TOTAL	609	148	757

NAVY PROGRAM DEFERRALS
(Current $ Millions)

	RDT&E	PROCUREMENT	TOTAL
Advanced Air to Air Missile	57	-	57
MK 48 ADCAP Torpedo	-	111	111
MK-50 Torpedo	-	79	79
Vertical Launch ASROC	-	53	53
TOTAL	57	243	300

In addition to those programs scheduled for cancellation in the FY 1989 amended budget, research and development efforts or planned procurements have been deferred for technical reasons, congressional action, or unique program circumstances. Some programs have had to be restructured to respond to congressional direction, such as the Army's Advanced Anti-Armor Weapon-Heavy (AAWS-H) and the Armored Family of Vehicles. The Army Data Distribution System has experienced technical delays. As briefed to the Congress in FY 1987, the Navy's MK-48 ADCAP torpedo has experienced production delays, while the MK-50 torpedo and Vertical Launch ASROC have experienced development delays. The Air Force's Defense Meteorological Satellite program has been delayed. Total FY 1989 program deferrals in the amended budget reduce funding by $1.1 billion.

NEW STARTS DELAYED
(Current $ Millions)

	RDT&E	PROCUREMENT	TOTAL
ARMY			
Non-Line of Sight Missile	-	66	66
Light Assault Bridge/Launcher	-	6	6
NAVY			
Low Cost Sonobuoy	-	27	27
Passive Signal Monitoring System	-	40	40
ASW Variant of V-22	18	-	18
New Warhead for MK-50 Torpedo	8	-	8
AIR FORCE			
B-1B Enhancements	165	-	165
Sensor Fuzed Weapon	-	111	111
TOTAL	191	250	441

Eight programs scheduled as new starts in FY 1989 were delayed. Delayed to FY 1990 were the procurement of Non-Line of Sight Missile and the Light Assault Bridge/Launcher for the Army; the Navy's Low Cost Sonobouy, ASW variant of V-22, new warhead for MK-50 torpedo and the Passive Signal Monitoring System; and B-1B Enhancements and the Sensor Fuzed Weapon for the Air Force. Delaying these programs reduced funding requirements in FY 1989 by over $400 million.

Amended FY 1989 Program Priorities

Manpower

Military and civilian manpower requirements are directly linked to force structure requirements. Therefore, revisions to force structure as a result of current funding constraints have also affected manpower levels. Congressional direction on officer reductions and provisions of the Goldwater-Nichols DoD Reorganization Act of 1986 have imposed other variables on the development of manpower requirements within the Department.

The amended budget supports a total force level of 2,138,300 full-time active duty personnel, a reduction of 46,100 from the force levels presented in the original FY 1989 budget submitted last year and a total reduction of 35,917 from actual FY 1987 levels. Likewise, the reserve force total of 1,173,000 reflects a decrease of 40,500 end strength from the original FY 1989 budget

DEPARTMENT of DEFENSE MANPOWER
(END STRENGTH IN THOUSANDS)

	FY 1988	FY 1989
MILITARY ACTIVE DUTY		
FY 1988/FY 1989 BIENNIAL REQUEST	2,172	2,184
ARMY	-9	-9
NAVY	0	-9
MARINE CORPS	-2	-3
AIR FORCE	-23	-25
TOTAL ACTIVE DUTY REDUCTIONS	-34	-46
FY 1989 AMENDED REQUEST	2,138	2,138
SELECTED RESERVES		
FY 1988/FY 1989 BIENNIAL REQUEST	1,190	1,213
REDUCTIONS	-18	-40
FY 1989 AMENDED REQUEST	1,172	1,173
CIVILIANS		
FY 1988/FY 1989 BIENNIAL REQUEST	1,123	1,125
REDUCTIONS	-11	-23
FY 1989 AMENDED REQUEST	1,112	1,102

but a total increase of 22,045 over actual FY 1987 levels. Civilian personnel end strengths have been reduced from 1,125,000 reflected for FY 1989 last year to 1,102,000 in the amended FY 1989 budget, a decrease of 23,000. The amended level represents a reduction of 30,884 civilian end strengths from actual FY 1987 employment levels. These reductions have been achieved through decreases in the force structure, consolidation of workload and general reductions and will be accommodated through reduced accessions and early release of military personnel and attrition of civilians. Although force structure reductions do not save a great deal of money in the near term, they save money every year thereafter in increasing amounts as more infrastructure savings are identified.

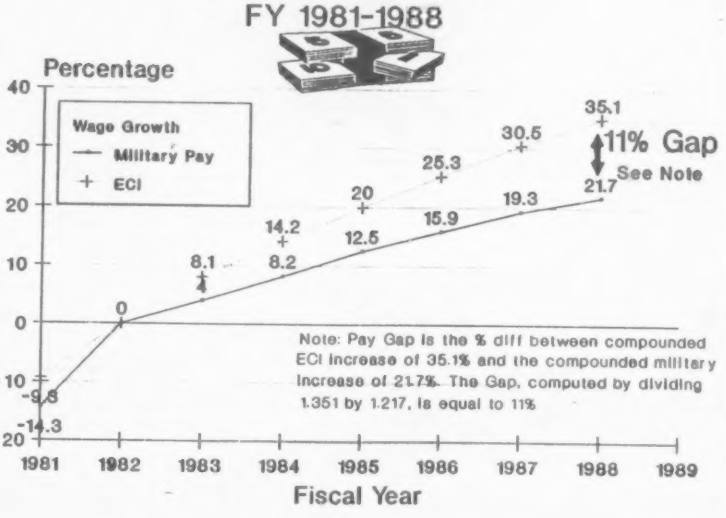
We have witnessed some dramatic achievements in the area of military personnel over the last seven years. Continued success in recruiting and retention of military personnel have made the volunteer force a favorable and economical alternative to conscription. Improvements in pay and benefits, increased opportunities for women, and better living and working conditions have contributed greatly to the desirability of a military career. Also, continued congressional support for the Department's morale, welfare, and recreation program has contributed materially to the Department's quality of life programs for service members and their families. FY 1987 was an outstanding year for recruitment. All Services met or exceeded their enlistment objectives and did so in spite of the shrinking pool of young people from which to recruit. Quantity has not been the only measure of success. The recruit today is of unprecedented high quality.

I have made every effort in this year's budget to preserve the significant gains in recruiting and retention. Included in the budget are a 4.3 percent pay raise and a 3.4 percent increase in the Variable Housing Allowance (VHA) for our military personnel to be effective January 1, 1989.

PEOPLE PRIORITIES

- COMPENSATION --4.3% MILITARY PAY RAISE
- VARIABLE HOUSING ALLOWANCE INCREASE
- SELECTIVE REENLISTMENT BONUS
- SPECIAL & INCENTIVE PAYS
- CONTINUATION BONUS FOR AIR FORCE PILOTS

WAGE GROWTH
FY 1981-1988



Note: Pay Gap is the % diff between compounded ECI increase of 35.1% and the compounded military increase of 21.7%. The Gap, computed by dividing 1.351 by 1.217, is equal to 11%

The military pay raises implemented early in this Administration served to help the military "catch-up" with the private sector in order to better compete in the labor market. As a result of improved pay and improvements in the area of benefits, the military became an attractive alternative for many young Americans and a career opportunity as well. Unfortunately, subsequent pay caps have seriously eroded those gains and today military pay raises are 11 percent behind private sector pay raises--worse than it was when this Administration first took office. The 4.3 percent pay raise included in this budget would roughly match projected private sector wage increases and prevent military pay from falling further behind. I have made a point of finding the funds to support a 4.3 percent military pay increase within the budget summit agreement levels and I ask the Congress to join with me in telling our uniformed men and women that their standard of living will not be the first victim of resource constraints.

The increase in VHA is also intended to prevent further erosion in that important allowance. Because of congressional restrictions, VHA rates have not been increased since FY 1986 even though housing costs have gone up by 8.5 percent during that period. As a result, military members are now absorbing, on the average, over 22 percent of housing costs out of pocket, as compared to the 15 percent they are intended to absorb under statute. The VHA increase in the budget would keep the housing cost absorption from getting even larger.

Current officer retention is stable with the exception of two critical officer communities: nuclear trained naval officers and aviators. The enhanced Nuclear Officer Incentive Pay authorized by the Congress in 1986 is expected to reduce the shortage in nuclear trained officers. However, the demand and competition for pilots from commercial aviation is expected to continue to exacerbate the shortage in this community. Continuing existing incentives and considering other alternatives are important if we are to remain competitive in this area. In particular, we are considering a new initiative which would provide an aviation officer continuation bonus to Air Force pilots.

We have now implemented a congressionally-directed reduction of 2 percent of our officer corps. I am concerned that we not make any further arbitrary reductions and that we understand completely the impact of any officer reductions. We are currently studying the proposed FY 1989-1990 cuts in concert with the force structure reductions we are making. We will report to you in March on the results of that study.

The budget reductions in civilian personnel end strength in FY 1988 and FY 1989 are primarily in the area of general base support and logistics activities. For the civilian workforce, the budget requests a 2 percent pay increase to be effective January 1, 1989. This is consistent with the Administration's government-wide request for civilian pay.

Operation and Maintenance

The emphasis placed on improving readiness is apparent in the Operation and Maintenance appropriations request of $85.6 billion. This reflects 2.4 percent real growth over FY 1988 approved levels and compares with the 4.8 percent real decline appropriated last year by the Congress. The outlay constraints in the budget agreement prohibited the Department from adding additional growth in readiness. Growth is reflected for operating tempo improvements and for increased depot maintenance efforts.

Additional funds have been requested to slow the rate of growth in the backlog of equipment waiting to be repaired. However, in order to provide the funding level required to maintain the readiness of the operating force, within the fiscal constraints of the FY 1989 budget, it has been necessary to reduce funds for base operations and general logistic support programs. Maintenance backlog levels will increase in both FY 1988 and FY 1989 as a result of budget limitations.

TRAINING PRIORITIES

- MEET ARMY GOAL OF 850 TANK MILES FOR GROUND OPTEMPO.
- MEET NAVY GOAL OF 50.5 STEAMING DAYS PER QUARTER FOR DEPLOYED FLEET.
- MEET AIR FORCE GOAL OF 19.3 TACTICAL HOURS PER MONTH

The FY 1989 budget represents the restoration of ground and air training operating tempo levels for the Army and Air Force that had been reduced under FY 1988 fiscal constraints. The Army has maintained its optimum operating tempo goals for FY 1989 of 850 training miles for major combat tracked vehicles and 15.8 flight hours a month for its aviation crews. Both the Army and the Marine Corps will maintain tactical unit proficiency through joint and combined training exercises at the National Training Center and the Marine Corps Air-Ground Combat Center.

While the projected naval force levels have been reduced in the near term, efforts have been made to protect readiness levels. By eliminating the operational support requirements associated with the 14th carrier air wing, which will not stand up in FY 1989, the Navy will be able to maintain its peacetime operating tempos at acceptable levels. Navy and Marine Corps tactical aircrews will average 25 hours of flying time per month in FY 1989, enabling them to maintain our readiness goals. The budget reflects operation of our naval forces at 50.5 steaming days per quarter for the deployed fleets and 29 days for the home fleets. These levels are consistent with our operational goals. Continued high levels of operation in the Persian Gulf, however, may require funding to be redirected and result in a reduction in at-home training.

As with the naval forces, the reduced level of tactical air forces has permitted the Air Force to maintain its goal of 19.3 flying hours per month for tactical aircrews.

Mr. Chairman, I want to emphasize as strongly as I can that these levels of training must be funded. The Department has made the hard priority trade-offs to supply the resources for these levels and I urge you to support them. Training is the key to readiness and the maintenance of a quality force.

Procurement

The Department of Defense has funded, in the amended FY 1989 budget request, those systems and technologies critical to maintaining our superiority in weapons capabilities. The budget requests $80 billion for procurement programs, a 4.3 percent negative growth for the procurement title. Despite this overall drop in procurement, the Department of Defense has attempted to fund major programs at the optimum economic level wherever technology or force requirements have made this desirable.

ACQUISITION PRIORITIES

- AIRCRAFT
  - 180 F-16
  - 72 AH-64
  - 72 UH-60
  - 72 F/A-18
  - 24 AV-8B
  - 12 F-14
  - 36 F-15
- MISSILES
  - 815 PATRIOT
  - 66 TRIDENT II
  - 510 TOMAHAWK
  - 12 PEACEKEEPER

ACQUISITION PRIORITIES

- SHIPBUILDING
  - 1 TRIDENT
  - 2 SSN 688
  - 1 SSN-21
  - 3 DDG-51
  - 1 LHD-1
- LAND FORCES
  - 559 ABRAMS (M-1) TANKS
  - 581 BRADLEYS
- COMMUNICATIONS & ELECTRONIC EQUIPMENT UPGRADE

The amended FY 1989 request includes 429 fixed-wing aircraft and 188 helicopters. The increase in the aircraft program reflects higher funding for the B-2A bomber, the procurement of improved models of the F-16 fighter, an increase in the C-17 program from 2 to 4 and an increase in Air Force aircraft spare parts. Aircraft procurement levels reflected in the budget will maintain our goal of 10 years average age for tactical fighter aircraft. The modernization of our reserve force is continuing as more F-16s replace the oldest F-4s.

The Army sustains both AH-64 and UH-60 helicopter production at 72 per year and provides for the Army Helicopter Improvement Program (AHIP) to modify 24 aircraft in FY 1989.

The Navy will, with congressional approval, upgrade a limited number of A-6Es in lieu of developing the A-6F model as previously planned. The Marine Corps has restructured its AV-8B program, reflecting a 44 aircraft reduction under a multiyear procurement planned for FY 1989 through FY 1991. As directed by the Congress, the final 34 AH-1W Super Cobras will be procured by the Marine Corps in FY 1988 and will sustain the current Marine Corps attack helicopter forces into the 1990s. Initial long lead procurement funding for the V-22 Osprey tilt-rotor aircraft program is requested in FY 1989. This aircraft will provide significant increases in operational capability, reliability and survivability for the Marine amphibious assault forces.

The increase in funding for missile programs reflects increased production quantities of AMRAAM, PHOENIX, STANDARD and MAVERICK missiles and continues improvements in the accuracy, reliability and survivability of our nuclear forces. While PEACEKEEPER missiles continue to be deployed in refurbished Minuteman silos in Wyoming, the longer term objective is to deploy PEACEKEEPERS in a basing mode that is more survivable, such as the rail garrison basing mode currently being considered. Only 12 missiles are requested in FY 1989 in recognition of congressional determination to approve no more than that level each year while decisions are pending on the basing mode. These twelve missiles will enter a pool of available test missiles while we work with the Congress to determine the appropriate basing mode. Once basing concerns are resolved, we would expect the Congress to insist on a more economical procurement level for these missiles.

The amended budget supports continued development of the Trident II (D-5) missile and production of 66 D-5 missiles. This missile will be deployed on the ninth Trident SSBN in late 1989. Production and deployment of the nuclear version of the Tomahawk sea-launched cruise missile continues in FY 1989 with a total complement of 758 to be deployed by the mid-1990s.

For the Army, no reductions were imposed on heavy armored or mechanized forces; those forces that would bear the brunt of combat with Warsaw Pact or comparably equipped opponents. The highest priority was given to procurement of 545 Abrams (M-1) tanks and 581 Bradley Fighting Vehicles.

The FY 1989 shipbuilding program includes $9.1 billion for the construction of 17 ships and two conversions. The first of the improved SSN-688 class submarines equipped with the AN/BSY-1 submarine combat system will join the fleet in 1988 realizing our goal of 100 attack submarines. To maintain this 100-ship force, with its qualitative superiority over Soviet submarines, will require the continued procurement of three to four submarines a year. The FY 1989 budget requests 2 additional SSN-688 submarines as well as the first SSN-21 Seawolf attack submarine.

The amphibious assault force program remains unchanged from last year, with the fourth LHD proposed for authorization in FY 1989.

The amended FY 1989 budget contains three AEGIS destroyers. Higher rates of procurement of Antiair Warfare (AAW) ships, such as the DDG-51, will be necessary in the future to offset projected retirements of older AAW ships. In the area of mine warfare, the FY 1989 budget continues to reflect the second and third MHC-51 minehunters and the remaining 7 MH-53E helicopters. Finally, the FY 1989 budget requests funds for the second of four planned AOE-6-class fast support ships.

The MK-48 Advanced Capability (ADCAP) torpedo has completed a successful at-sea testing program and will proceed with limited production in FY 1989.

Research, Development, Test, and Evaluation

The FY 1989 RDT&E title request of $38.2 billion reflects no real growth over FY 1988 levels. Many programs have been restructured, reduced, deferred and, in some cases, terminated.

In the current resource environment, the Administration does not feel two mobile missiles to be affordable or cost effective. The Department believes the PEACEKEEPER rail garrison concept is far more cost effective than Midgetman and this basing mode development effort is being fully funded. In the interest of maintaining a strategic consensus with the Congress, however, the budget proposes preserving the option of continuing the Small ICBM development program for a final decision by the next administration. The budget reflects the $700 million appropriated in FY 1988 and requests $200 million in FY 1989 to support continued development of the Small ICBM and its basing mode through FY 1989. No funds have been included in the outyears.

While the United States needs an operational ASAT to counter the Soviets and deter exploitation of their current monopoly, continuing congressional prohibition of testing of the air-launched miniature vehicle (ALMV) against targets in space has forced cancellation of the ALMV ASAT program. I believe the congressional restrictions represent an extremely unwise decision in terms of deterrence credibility, but I cannot afford to budget scarce resources on a program we are unable to test. The Soviets already have a deployed antisatellite (ASAT) system. Should the Congress decide to allow us to test an effective deterrent to the Soviet ASAT capability, the Department would be prepared to reinstate the program immediately.

The MK-50 torpedo program, having been restructured in FY 1987, is now on track for fleet introduction in FY 1991. Development of the Sea Lance ASW standoff weapon has been limited to initial missile tests in order that this program can be reviewed this summer before making any long term commitment.

In addition to continuing procurement of existing aircraft models, modernization efforts include the investigation of advanced derivatives of the F-16 and the F/A-18 aircraft to complement a new generation of tactical aircraft currently under development - the Air Force's Advanced Tactical Fighter (ATF) and the Navy's Advanced Tactical Aircraft (ATA). Consistent with congressional direction, both the ATA and ATF programs are being developed jointly and will be designed to include the unique requirements of both Services.

The budget includes $4.5 billion to continue the demonstration and validation program essential to a feasibility decision on advanced strategic defense. However, as a result of congressional reductions in FY 1987 and FY 1988, the SDI program effort has had to be restructured. The options for accommodating substantial budget cuts, based on the essential need to maintain a strong technology research program, were limited to reductions in integrated experiments and/or shifting from the balance between mature and advanced technology. Since its inception, a series of technology developments and experiments have underscored the potential for using advanced technology to construct an effective defense. Most recently, the ability to intercept targets within the atmosphere and space has been demonstrated. There have been significant advances in several directed energy and sensor technologies as well as in system architecture and operating concepts. Six major elements comprising a possible initial defense system were approved by the Defense Acquisition Board (DAB) for entry into the demonstration and validation phase. The purpose of this phase is to evaluate the feasibility of critical elements of a potential Strategic Defense System (SDS).

Military Construction/Family Housing

The budget requests $5.7 billion for military construction and $3.3 billion for family housing in FY 1989. This represents real growth of 2.5 percent over FY 1988 levels. The requested levels are considered the minimum necessary to support new weapon systems being deployed, to accomplish new or changed missions and to provide adequate living and working conditions for servicemembers and their families. While essential mission and quality of life projects are funded, the backlog of facility requirements will continue to grow. The budget funds construction in support of major programs, such as the Advanced Technology Bomber, TRIDENT, and PEACEKEEPER. It also provides funding for the Strategic Defense Initiative, the Navy's Strategic Homeporting Initiative, Fort Drum, New York and Fort Wainwright, Alaska.

Family housing construction represents our commitment to improve the living conditions of military personnel and their families. The FY 1989 request funds construction of 3,226 new family housing units; improvements for over 16,900 existing units; and the leasing of more than 27,700 foreign housing units, 2,300 domestic units and 7,100 Section 801 units under the build to lease program.

Management of Defense Resources

One of the highest priorities within the Department under this adminstration has been to refine and improve upon our management practices to ensure that our defense resources are spent wisely and effectively. I intend to continue these efforts and have structured an acquisition strategy based on three underlying principles of stability, quality, and partnership.

The cornerstone of this strategy is stability, and yet it is the hardest to achieve. Providing the Department of Defense with the degree of management authority and flexibility as well as timely authorization and appropriations so critical to efficient planning and program execution will require significant revisions to current attitudes and processes. And, though revisions are not likely to occur overnight, they can be realized through increased cooperation between the executive and legislative branches and between government and industry. First and foremost, we must achieve budget stability. It is impossible to plan and pursue a sensible acquisition strategy when resources remain an unknown variable until provided under continuing resolutions, often well into the fiscal year. I am pleased with the continued support within the Congress for the two-year budget concept, for it will provide the stability necessary for successful pursuit of such money-proven practices as baselining and multiyear procurement. Stability in defense acquisition, in turn, can provide the incentive for industry to make the investment so crucial to our nation's industrial base.

I intend to introduce a total quality management strategy in the Department and to its contractors. Studies have shown that 95 percent of the effort involved in producing a product is related to efforts other than the actual physical production of the product. We will focus on the inefficient and costly practices that occur within this 95 percent. Further, 40 to 50 percent of the life-cycle costs of weapon systems lies in logistics support. If we can ensure that the original product is of high quality, then we should be able to reduce these costs. We want to break from the traditional idea that quality means merely conforming to specifications. Quality should be the responsibility of the entire acquisition team from design through production to deployment and should be the primary consideration from the very first day of a program's life.

Implementation of any strategy to improve quality in defense products and in management requires the cooperative participation of industry. In recent years, aggressive efforts to improve the acquisition process within the Department have strained its relationships with industry. While the relationships should be at arms length, they should not be adversarial. We intend to seek positive and cooperative ways for the Department and industry to work together to cut costs and inspire quality. We will work to eliminate the burden of multiple reviews by contract officers and auditors. This does not mean that we are abandoning our commitment to reduce waste and fraud. Rather, we want to free contractors to pursue efficiency and quality. And, we need to reduce and clarify acquisition regulations throughout the system. To this end, we are working with the Congress and the Office of Management and Budget to replace the maze of acquisition legislation with a single, understandable law.

I cannot stress enough that the underpinning for this effort as well as all our management improvements remains stability. Stability is the key to effective program management, quality performance, and affordability of our defense program. Stable funding by the Congress is a prerequisite to meeting program cost and schedule goals; stable well-considered requirements, understood and supported by government and contractor, will eliminate costly changes later; and a stable legislative and regulatory environment allows creative and experienced people to fully exploit the tools provided in their search for improved quality and reduced cost.

Other Defense Budget Issues

Limited defense resources now and in the foreseeable future have highlighted some specific problems that we are experiencing in the Department of Defense. I would like to address some of these issues now.

INF Verification

Mr. Chairman, I have already discussed the importance placed on maintaining readiness as demonstrated by the Operation and Maintenance funding levels for FY 1989. But our operating accounts have been under stress from many increasing or emerging requirements. Support costs for INF Treaty Implementation are estimated to be $198 million in FY 1988 and $148 million in FY 1989. Costs associated with implementation of this treaty include those relating to personnel, travel and transportation, contract support and supplies and equipment for management personnel and inspection and escort teams at sites in the United States, basing countries and the USSR. They also include costs associated with destruction and elimination of missiles, launchers and facilities and other activities conducted in conjunction with the implementation program.

NATO Programs

The signing of an intermediate-range nuclear forces (INF) agreement in December 1987 highlights the importance of our continuing effort to modernize and strengthen NATO's nuclear and conventional forces.

In 1983, NATO Defense Ministers agreed at Montebello to modernize theater nuclear forces. Major programs stemming from the Montebello Decision that have a direct bearing on the United States include:

- Modernization of NATO's dual-capable aircraft and their nuclear bombs;
- Development of a tactical air-to-surface missile to replace a portion of the nuclear bombs delivered by U.S. and allied aircraft;
- Development of a follow-on system to replace the aging LANCE deployed with U.S. and allied forces; and
- Production of sufficient modern nuclear artillery rounds.

Most of these systems are included in our FY 1989 Amended Budget. All will be given high priority as the Department reviews its future defense plans and consults with other NATO governments. We are proposing that Congress lift the current limitation on nuclear artillery rounds. We also need removal of the restrictions on further development of ATACMs as a follow-on to LANCE.

NATO NUCLEAR & CONVENTIONAL FORCE IMPROVEMENT PROGRAM

THEATER NUCLEAR FORCES

Modernize NATO's Dual Capable Aircraft and associated Nuclear Bombs.

Develop a Stand-off Tactical Air-to-Surface Missile (TASM).

Modernize NATO's Artillery-Fired Atomic Projectile and .Seek removal of Congressional Restrictions on production of nuclear Artillery.

Develop a Follow-on to LANCE with increased range, improved accuracy, and improved operating characteristics.

CONVENTIONAL FORCES

Continue Procurement of modern systems such as M-1 Tanks, F-15 fighters, and AEGIS Destroyers.

Develop Reconnaissance RPV's.

Develop highly accurate conventional Cruise Missiles.

Procure TACIT RAINBOW defense suppression missiles.

Continue to procure AMRAAM, PHOENIX and third generation Anti-Tank Weapons.

Develop MLRS, ATACMS, JSTARS and new Stand-off Air-to-Surface Missiles (TASM).

Develop and procure Forward Area Air Defense Systems (FAADS) and Improved PATRIOT Missiles.

Continue development of MK-15 System for Aircraft Identification.

Another important part of our NATO Defense Program is the U.S. contribution to the Conventional Defense Improvements initiative launched by NATO in 1984. We must continue to modernize our conventional forces with new equipment to retain our technological edge on the battlefield. The M1-A1 tank, F-15 fighter and AEGIS destroyer are examples of relevant procurement programs. We must also look ahead with research and development programs to further enhance our capability to conduct a flexible conventional response. We are developing tactical reconnaissance RPVs and highly accurate conventional cruise missiles capable of being launched from air and sea platforms to locate and strike critical targets deep in Warsaw Pact territory. Additionally, we plan to enter production in FY 1989 with Tacit Rainbow, a defense suppression missile which will greatly increase our effectiveness against enemy air defenses.

To ensure an effective conventional capability, we must also support programs such as POMCUS, airlift and sealift to enable us to achieve our goal of ten divisions in Europe ten days after mobilization. We must continue to develop and procure modern munitions such as AMRAAM, Phoenix and third-generation antitank weapons. Our ability to attack second-echelon Warsaw Pact forces must be further developed with systems such as MLRS, ATACMS, JSTARS, new standoff air-to-ground missiles, and the joint tactical fusion program. In the area of advanced cruise missile guidance, we are exploring several innovative technologies that we hope to incorporate in weapons production as soon as feasible. To control our air space and protect our aircraft we are continuing to improve, develop and field modern air defense systems such as FAADS and Patriot. Our contributions to NATO Infrastructure are providing hardened aircraft shelters and essential facilities at collocated operating bases in Europe. In addition, we are working with our NATO allies to develop a common system for aircraft identification. We will continue to devote special attention to such programs as we seek to strengthen our conventional posture in Europe.

We are also pursuing our competitive strategies initiative with an initial focus on the European theater. The task force on Europe developed proposals to improve NATO's defense posture in areas involving Soviet command and control and countering Soviet air and ground operations. The proposals exploit the Soviet requirement for strict time management and maintenance of a high operational tempo. NATO advantages in data automation and processing, target acquisition and intelligence fusion and dissemination can take advantage of this dependence, providing for more effective use of NATO's conventional capabilities.

These competitive-strategy proposals to improve NATO's defense posture center on new and improved military capabilities that share a number of common characteristics; for example: various unmanned systems (e.g., surface to surface, precision stand-off, air-to-surface and cruise missiles, drones and RPVs), area munitions, various extended-range tube-launched projectiles, rapidly emplaceable barriers, precision-penetrator warheads and smart submunitions. The task force recommendations take advantage of advances in automatic data processing, intelligence fusion and electronic miniaturization. Each of the recommendations can be enhanced through extensive use of low-observable technologies and an integrated command, control and communications system. The greatest effect would be gained by synergistic employment of these capabilities in combination with a robust NATO-wide command and control system.

The task force's recommendations are now being staffed within the department to determine the best ways to implement them. In addition, the Task Force Report has been provided to the Commanders in Chief (CINCs) of the Unified and Specified Commands, who will play an important role in implementing any competitive strategy adopted.

FY 1988 Funding Problems

FY 1988 UNFUNDED REQUIREMENTS
($ in Millions)

Overseas Station Allowance	**500**
CHAMPUS	**645**
INF Treaty Implementation	**198**
Foreign Currency Fluctuation	**930**
Industrial/Stock Fund Transfer Refunds	**523**
Civilian Pay Raise	**416**
Civilian Health Service	**200**
Fuel Price Increases	**361**
Persian Gulf Operations	**175**
GSA Stock Fund Surcharge	**64**
TOTAL	**4,012**

Mr. Chairman, there is a serious FY 1988 operating issue upon which I want to place special focus. Sizeable FY 1988 O&M appropriation reductions, coupled with skyrocketing uncontrollable costs, have created problems in program execution that rob management of the flexibility needed to deal with program requirements or operations. There has already been a great deal of publicity about actions the Air Force and Army are taking in FY 1988, including furloughing of civilian personnel, to deal with these situations. Transfer authority is one of the most important management tools we have available to meet and respond to such changing situations. The FY 1988 transfer authority of $1.5 billion provided by Congress will be consumed rapidly by such requirements as implementation costs of the INF Treaty, increased CHAMPUS costs, absorption of the 1988 military and civilian pay raises and higher fuel costs. I sincerely urge your support for our request to increase the Department's level of transfer authority to $4 billion in FY 1988 and $3 billion in FY 1989. Also, approval is essential of our proposed legislation allowing utilization of prior year balances to offset increased foreign currency and overseas station allowances resulting from the decline in the value of the dollar. Disapproval of this requested authority is a defacto cut in readiness programs of almost $2 billion annually. Lastly, I encourage your strong support for defense readiness efforts--including prompt approval for must-pay readiness-related reprogramings. In this period of constrained resources, we must forge a partnership to protect the most critical of our defense needs and provide our managers with the flexibility to do their job.

Conclusion

Mr. Chairman and Members of the Committee, the amended FY 1989 defense budget before the Congress reflects significant force structure reductions--fewer ships, fewer aircraft, fewer weapons systems--that have long-term implications for our national security. This follows three years of negative growth in defense funding levels and is a direct consequence of complying with the budget summit agreement. We must weigh carefully our future decisions on defense budgets and programs if we are not to reverse the substantial achievements in our military forces realized at great cost over the last seven years.

Mr. Chairman, I hope the fact that we already have a binding defense topline, as a consequence of the budget summit, means that the Congress will be able to move quickly to approve the FY 1989 amended defense budget request. The management challenges posed by current resource limitations make it all the more important to have funds authorized and appropriated without delay.

Next year the Department will again present a biennial budget for defense. I urge you to consider and approve the budget for FY 1990 and FY 1991 next year. Only through two-year authorizations and appropriations can we begin to realize even a modicum of stability so critical to rational and efficient planning and execution of defense programs. The two percent real growth I am projecting for defense planning over the next five years represents a major reduction and merits full support from the Congress. It is critical that we use the opportunity, arising from the budget summit, to work together to provide realistic and stable funding levels for defense programs. Real defense acquisition efficiency can only proceed from a stable and predictable funding pattern. My staff and I are prepared to assist you in any way we can as you review the defense programs contained in this amended FY 1989 budget.

Chairman CHILES. I just want to tell you and to apologize in advance—we are going to have a series of votes that are going to begin shortly. They are going to follow in 10-minute intervals. I think we will just try to stagger our leaving and coming so that we can keep the hearing going. That would be the best thing we could try to do for the Chairman, and we will try to hold to 5 minutes on the first round so that everybody will get a shot.

Admiral Crowe.

STATEMENT OF ADM. WILLIAM J. CROWE, JR., USN, CHAIRMAN, JOINT CHIEFS OF STAFF

Admiral CROWE. Thank you, Mr. Chairman.

As you say, we will just play through the procedural problems.

I welcome this opportunity to discuss America's military posture. I have submitted a formal statement for the record, but with your permission, I will just summarize it.

Chairman CHILES. Thank you, sir. It will be included in the record in full.[1]

Admiral CROWE. My written submission commences with a global review, highlighting a number of continuities, changes and challenges in the world around us—all of which I believe will bear heavily on our national security and defense effort in the years ahead.

Its fundamental conclusion is that from a U.S. perspective, the immediate and most pressing challenge is to strike a course which both nourishes our economy and offers a lesser, but under the circumstances, reasonable, level of security.

This challenge, of course, inspired the budget summit agreement which has shaped the fiscal year 1989 budget request.

I must stress, however, at the same time it should be recognized that in a democracy, seemingly small reductions in peacetime capability may result in large increases in risk, and it is imperative that our Nation understand these facts of life.

I hear, as the Chairman, a great deal of comment about fiscal and political realities; I think an important part of this debate should also be the military realities.

Clearly, the Soviet Union remains the dominant threat to our national security and to a more stable international environment. World power is still the name of the game in the Kremlin, and Communist Party leaders will do what is necessary to play in that game.

As a reminder of this policy, the U.S.S.R. over the last two decades has built the world's largest military force, supported by a huge arms production base and a steady research and development program. Their power projection capabilities are increasing at a steady pace, not only on and around the Eurasian continent, but also in the Thirld World and in space.

Even more worrisome, we are now seeing our traditional qualitative military edges erode.

This is not to say that there are no flaws in the Soviet military machine. There are. To cite some of the more prominent: personnel problems; the lack of a regular corps of noncommissioned officers; training deficiencies; logistics distribution problems; unreliablity of equipment; poor maintenance, and highly centralized command.

---

[1] See p. 105.

Overall, the Soviet armed forces are confronted with serious vulnerabilities as well as impressive strengths.

On a more fundamental level, there may be even more important forces at work. General Secretary Gorbachev and his Party colleagues seem to have concluded that the Soviet Union cannot remain a first-rate world power with a second-rate industry. Unquestionably, he wants to reshape his economy.

It is not clear at this point whether he will succeed, or what his policies will mean in terms of military spending or arms reductions. Conceivably, it may be possible to develop a more stable and sustainable relationship with the Soviet Union. Much depends, however, upon United States and allied resolve to render Soviet military power less coercive and less dangerous over the long haul. As Secretary Shultz recently observed, we must be prepared to deal with the best and the worst of Soviet behavior.

In my written statement you will find again this year a net assessment of the United States and allied capabilities versus the Soviet Union and Warsaw Pact. The assessment covers eight specific categories—four functional and four regional.

Frankly, I cannot do justice to each of these functions and regions without taking up the time this committee would prefer for questioning. Therefore, in these few minutes I will focus my compressed remarks on the strategic balance, maritime situation, and forward defense in Asia and Europe.

In my view, these balances tend to be the most complex and deserving of detailed comment.

With respect to the strategic balance, we worried 10 years ago about losing our strategic superiority. Today, our primary concern is to maintain strategic parity with the Soviet Union. In and of itself, that is a major challenge, because the Kremlin continues to finance a robust program to improve both strategic offensive and defensive systems.

Nevertheless, our improving ICBM inventory, superior missile submarines, and penetrating bomber force still represent an impressive capability.

Moreover, the President's Strategic Modernization Program, if fully implemented—and I am referring to the MX, the D-5 missile, the B-1 bomber, the advanced tactical bomber, and the advanced cruise missile and some command and control initiatives—will prepare us for the long haul.

In addition, the SDI effort obviously concerns the Soviets. We would be wise to nourish that concern.

All things considered, I am relatively confident that our Triad will continue to deter a direct nuclear attack on the United States. For that judgment to continue to be solid, however, it is imperative that we stay the course with our Strategic Modernization Programs.

On the maritime front, the Soviets operate the largest navy in the world in terms of numbers. It is tailored primarily for wartime sea denial missions. Soviet success in building ships with advanced naval weaponry continues to challenge our traditional blue water superiority. We will be hard-pressed to penetrate Soviet sea denial zones and maintain essential communications lines to both Europe and Asia.

Clearly, the key to success lies in the full integration of capabilities resident in our carrier battle groups, nuclear attack submarines, maritime patrol aircraft, our surface action groups, amphibious forces and replenishment units—plus strong support from the allies in terms of choke point control, mine clearance, land-based tactical aircraft, and especially naval escorts.

If all of these forces can be brought into play—and that is a big "if"—and we can avoid future force structure cuts, the odds are reasonable that the United States and its allies can gain ultimate control of the vital sea areas and that the United States can support its forward-deployed forces.

I must reemphasize, however, that the margins in these calculations are very thin. Overall, I would argue vigorously that we cannot afford to relinquish naval superiority to the Soviets. To do so would jeopardize our coalitions, economic dependencies—which are now necessary in war as well as peace—and capabilities to project our power overseas. Our ability to prevail at sea is a cornerstone of our overall global strategy.

My assessment of the Pacific region has changed little since last year. That is, I judge the posture of the United States and allied forces in the Pacific sufficient to deter the Soviets from a major attack in that theater, and if deterrence fails, to prevent them from achieving their military objectives.

The Korean peninsula remains a major security concern. However, the Republic of Korea, with Washington's support, is equipped to deal with any threat from the north that does not involve either the U.S.S.R. or the People's Republic of China.

Generally, our political relationships in this region work in our favor—in Japan, the Philippines, Thailand, Australia, and even the PRC. I am inclined to believe that any United States-Soviet confrontation in the Pacific would take its lead from Western Europe or elsewhere.

Looking ahead, long-term deterrence in the Pacific will depend heavily on a general upgrade of regional air defenses, the introduction of long-range interceptors and attack aircraft, and command and control and communications which can optimize the employment of United States as well as allied tactical air forces.

For nearly four decades, the pace and effort required by NATO have been driven by a steady expansion and modernization of Soviet capabilities, both conventional and nuclear. To this day, the balance of weaponry weighs heavily against NATO.

From the outset, it became clear that the United States and its partners could not match Warsaw Pact numerical advantages in forces and weapons systems. In the 1960s, the coalition reacted by adopting a defensive philosophy which aimed to keep the Soviet level of uncertainty very high.

At first, the convincing United States nuclear advantage underwrote this doctrine. But as increasing numbers of Soviet nuclear weapons occurred, the alliance turned to a flexible response strategy, with emphasis on quality forces and a balance of weaponry across the spectrum from conventional to theater nuclear weapons to strategic forces.

As a consequence of these policies, conventional force modernization has for two decades been a significant theme in NATO defense planning. Over the last 8 or 9 years, the United States has been in the forefront of this effort, and our force posture in Western Europe has steadily improved.

As a result, Soviet military power there is less coercive and less dangerous than it might have been otherwise.

The NATO qualitative edge in tactical aviation, while somewhat diminished, has not totally disappeared. It is not clear, however, what this will mean against the numerical advantages of Soviet air forces, which run in the neighborhood of two- to three-to-one. I have complete confidence that the quality of our pilots and weapons systems would permit us to exact high exchange ratios, but overcoming the impressive numbers of Russian medium-range bombers, fighter bombers, interceptors, and surface-to-air weapons systems will be a sporty course at best. The outcome is difficult, if not impossible, to predict.

Our assessments go behind the numbers in an attempt to evaluate a wide variety of inputs including Soviet personnel weaknesses, Moscow's reliance on satellite troops, logistics demands, intangibles such as morale, et cetera.

The bottom line is that NATO capabilities are still deterring in Europe; but both the level of deterrence and the nuclear threshold remain too low. The Chiefs have for a number of years consistently testified to that effect.

If for some reason war breaks out in Western Europe, maintaining a successful forward defense will be questionable. Our analysis argues strongly that Soviet conventional ground forces will be extremely difficult, if not impossible, to contain.

Especially worrisome is a pronounced Soviet advantage in chemical warfare capabilities. Even if they could be defeated—and this is a highly controversial proposition—it would be at a very high cost in lives, treasure, territory, and time.

Thus, all things considered, it is imperative for the alliance to preserve the gains made in the 1980s and move forward with programs which will promote a higher degree of uncertainty in the minds of Kremlin planners and disrupt their war-fighting timetable.

On balance, the level of risk is much too high today in NATO. This thought is at the center of a number of initiatives to revive the coalition's war-fighting capabilities. Examples include the conventional defense initiatives program; long-term competitive strategies; NATO defense initiatives; and the Montebello Agreement.

It is imperative we draw these efforts together and enhance the cutting edge of NATO's existing forces and continue to modernize the theater nuclear assets allowed by the INF Treaty. We are working hard in the Pentagon to do precisely that.

In summary, it is clear that the investments made in the last few years have materially improved the foregoing global net assessment from the United States standpoint. It is equally obvious that the picture is a mixed and dynamic one; the Soviets are working diligently to improve their position across-the-board, and there are still a number of serious gaps in our own posture.

As indicated last year, before we can correct those gaps, we have a number of years of growth before we can face the future with confidence—the kind of confidence that I would suggest befits the leader of the free world.

Now, to the defense budget.

This budget has been carefully and tightly constructed to fit within a firm, pre-set commitment, and there is a careful interlocking of constituent elements. Simply put, the budget elects a slightly smaller force in order to protect quality throughout and our ability to fulfill alliance commitments. Its main priorities, as set forth by Secretary Carlucci, are people, readiness, and efficient acquisition. The budget is faithful to those goals and is treated at great length in the Secretary's statement. I will mention only some of its more prominent features.

Throughout the budget, the proposed budget attempts to protect programs which directly affect quality of life, morale, and retention curves. Today's performance, spirit, and training of the armed forces are the best I have witnessed in over 43 years of service, and the Chiefs are determined not to let that quality deteriorate.

Never again do we want to return to the hollow forces of the 1970s.

Additionally, this budget nourishes capabilities which only the United States can provide for itself and for allies who depend upon us—that is, nuclear deterrent, maritime superiority, strategic mobility, special operations forces, and associated command and control capabilities.

In more detail, the fiscal year 1989 budget was structured to provide a 4.3 percent pay raise for our military personnel; to maintain efficient levels of production; to sustain spare parts and low-technology munitions at about current levels; to reverse severe fiscal year 1988 cuts in operations and maintenance; to keep pace with mission-essential and quality of life military construction projects; to suppport NATO conventional and theater nuclear force improvements, and to remain on a steady path of revitalization of our special operations forces.

In order to protect these capabilities, we were forced to cut back in a number of ways. With respect to the conventional force structure, virtually all of the reductions will occur in our CONUS-based strategic reserve. Additionally, the procurement of conventional military equipment has been cut back by 16 percent, compared with the original budget submission for fiscal year 1989.

Overall, these cost avoidance measures will have only limited impact on our current forward defense posture. But I must emphasize that as far as NATO is concerned, it is a status quo budget and will not materially improve our position vis-a-vis the pact. To do that, we would have to have a higher top line.

In the area of strategic and space programs, you will find that the budget preserves options to deploy land mobile missiles and ensures that we will maintain a space launch capability sufficient to support our basic peacetime military requirements. It unfortunately has had to reduce our investment in some space programs which provide important hedges for the future.

Overall, the fiscal year 1989 budget recognizes that a coalition strategy has become more, not less important to the United States. We are not well-positioned, however, to fill the gaps if for one reason or another some of the allies decide to reduce their own defense efforts.

To conclude, it is clear that investments made in the early eighties have from our perspective improved the global military balance. However, the Soviets have not slackened their efforts, and the threat remains an imposing one. Those are military realities.

The fact that we still have serious gaps in our own posture, combined with 10 percent negative growth in security appropriations since 1985, will inevitably push the level of risk—and I repeat, the level of risk—higher.

If this trend continues, we will be forced not only toward further drawdowns in force structure, but also cutbacks in quality, which the current budget has worked very hard to avoid. In that event, many of the gains we have made in the 1980s would unravel, and the risk would escalate precipitously.

We have for this one year provided for short-term concerns but put aside some of the challenges and costs of the long-term military competition with the Soviet Union.

Believe me, that race will not go away just because we would prefer to save money. We are engaged in a security marathon—not a sprint—and it would be folly to conclude otherwise.

Thus, the Joint Chiefs of Staff strongly concur with Secretary Carlucci's conclusion that we should aim for 2 percent real growth in the biennial fiscal year 1990–91 budget submission.

That concludes my statement, Mr. Chairman.

Chairman Chiles. Thank you, Admiral Crowe.

[The prepared statement of Admiral Crowe follows:]

STATEMENT OF
ADMIRAL WILLIAM J. CROWE, JR., USN
CHAIRMAN OF THE JOINT CHIEFS OF STAFF
BEFORE THE
SENATE BUDGET COMMITTEE
ON
THE FY1989 DEFENSE BUDGET

3 MARCH 1988

INTRODUCTION

Mr Chairman and members of the Committee: I welcome this opportunity to discuss America's military posture in connection with your hearings on the Fiscal Year 1989 budget.

NATIONAL INTERESTS

To begin, the President's Report on National Security Strategy, emphasizes a number of basic national interests:

- o Survival of the United States as a free and independent nation, with its fundamental values intact and its institutions and people secure;
- o A healthy and growing U.S. economy to provide opportunity for individual prosperity and a resource base for our national endeavors;
- o A stable and secure world, free of major threats to U.S. interests;
- o The growth of human freedom, democratic institutions, and free market economies throughout the world, linked by a fair and open international trading sytem; and
- o Healthy and vigorous alliance relationships.

A forward-looking and fully-integrated national strategy, of course, must do more than focus on fundamental interests. From time to time, governments must take stock of continuities, changes, and challenges in the world around them.

GLOBAL REVIEW

In the broad sweep, continuities include a Communist Party of the Soviet Union determined to compete head-on with the U.S. for global power and influence; a vast and modern Soviet military apparatus designed for offensive operations; industrial European allies of the United States living under the shadow of Soviet military power; irreversible interdependencies on the global economic front; chronic instabilities in the Third World; and an exponential pace of discoveries in science and technology.

From a U.S. military perspective, the continuities include: a policy which emphasizes the deterrence of war; a network of collective security arrangements buttressed by a forward-deployment posture and access to overseas bases; combined defense planning with allies; and a willingness to pursue effective and verifiable arms reduction agreements.

Changes are most evident in the global balance of economic power--the industrial and financial resurgence of Western Europe, Japan, and other Pacific Rim countries; the momentum of agricultural and industrial development in China and India; an external debt crisis sweeping across Eastern Europe and parts of Latin America; a large national debt looming over the United States; and stifling inefficiencies in the Soviet economy.

Concurrently, every major power is standing on the threshold of nothing less than another industrial revolution--essentially new technologies, materials (superconductive, high temperature, and low observable), manufacturing processes, machine tools, and products which now exist largely on paper. In the long term, our ability to remain at the forefront of this competition will have a major bearing on our national defense potential and our ability to work for peace and stability in the world at large.

The immediate and very difficult challenge is to strike a course which both nourishes our economy and offers a lesser, but under the circumstances reasonable, level of security. This challenge, of course, inspired the Budget Summit Agreement which has shaped this year's budget request. At the same time, it must be recognized that such a decision mortgages our military future to some extent and will ultimately involve increased military risks. I pointed out last year in my opening statement that our military forces have in peacetime historically operated on the margin. This is appropriate for a democracy, but it means that seemingly small reductions in our peacetime capability may result in large increases in risk. It is imperative that our citizenry understand these facts of life.

SOVIET THREAT

Throughout, the Soviet Union remains the dominant threat to our national security and to a more secure and stable international environment. World power is still the name of the game in the Kremlin, and Communist Party leaders will do what is necessary to play in that game. For instance, the Kremlin remains as firmly committed as ever to a long-term military competition with the West and to the support of so-called "wars of national liberation" in the Third World.

As a reminder of this policy, the USSR over the last two decades has built the world's largest military force (both nuclear and conventional), supported by a huge arms production base and a steady research and development program. Power projection capabilities are increasing at a steady pace not only on and around the Eurasian Continent but also in space. The Free World has accommodated to the Soviet penchant for numbers, but even more worrisome we are now seeing our traditional qualitative edge erode. I won't dwell on specifics since you are thoroughly familiar with the depth and breadth of the Kremlin's impressive military investment.

This is not to say that there are no flaws in the Soviet machine. There are. To cite some of the more prominent, personnel problems are pervasive. Many units are cadre formations which in war would be filled out by personnel far less competent than today's front-line units. Conscripts serve only two to three years and their training leaves a great deal to be desired. Technical tasks are in the main performed by regular officers and the lack of initiative at lower levels is a prime concern of Soviet leadership. This situation is exacerbated by the lack of a regular core of career NCO's and some persistent ethnic problems. Combine these personnel problems with training deficiencies, logistic distribution problems, unreliability of equipment, poor maintenance, highly centralized command, and we find serious vulnerabilities which plague the Soviet military.

On a more fundamental level, there may be even more important forces at work. General Secretary Gorbachev and his Party colleagues seem to have concluded that the Soviet Union cannot remain a first-rate world power with a second-rate industry. Unquestionably, he wants to reshape the economy; it is not clear whether he will succeed.

On the military front, Gorbachev reportedly has suggested that Soviet General Staff move from a war-winning posture to something called "reasonable sufficiency." We still do not know what that means in terms of military spending or force structure. We do know that the Soviet military and the Russian people have little stomach for unilateral disarmament, and we have yet to see any tangible cutbacks in military spending or production. Thus, if Gorbachev is going to reduce the burden of military expenditures, he must do so in the broader context of his arms control agenda.

Certainly, the successfully negotiated INF Treaty demonstrates the type of opportunities that the arms control dialogue offers. Asymmetrical reductions as achieved in this Treaty can help redress imbalances adverse to the Free World. But no arms agreement can prevent the Soviets from shifting resources from one military pocket to another. Whatever the arrangements, the Soviets will modernize and readjust their forces to get the most out of their investment. At least for the foreseeable future the West must do likewise. It would be misleading at this juncture to view INF and ultimately START as money-saving exercises.

Looking ahead, it may be possible to develop a more sustainable relationship with the Soviet Union. Much depends, however, upon U.S. and allied resolve to render Soviet military power less coercive and less dangerous over the long haul. As Secretary Shultz recently observed, we must be prepared to deal with the best--and the worst--of Soviet behavior.

As we move into the future, the President's Bipartisan Commission on Integrated Long-Term Strategy also has offered some sound advice on how to deal with the Soviet threat:

o We must maintain a mix of survivable strategic offensive arms and command and control capabilities that can, in all circumstances, respond to and thus deter a massive nuclear attack intended to eliminate our nuclear forces and other targets.

o To help defend our allies and to defend our interests abroad, we cannot rely on threats expected to provoke our own annihilation if carried out. In peacetime, a strategy based on such threats would undermine support for national defense. In a crisis, reliance on such threats could fail catastrophically for lack of public support.

NET ASSESSMENT

Last year I summarized my own net assessment of U.S. allied military capabilities. This year, as a result of the Goldwater-Nichols Act, the Joint Staff has completed its first in-depth net assessment. I should stress that it will be several years before this process is refined and yields the comprehensive results we are seeking. Nonetheless, I have drawn heavily on this joint effort for my capsulized assessment this year.

SOVIET ARMS PRODUCTION

Overall, industrial potential clearly favors the U.S. and its allies as compared with the Warsaw Pact. Today, for example, our gross national product is nearly twice that of the Soviet Union. Similarly, NATO as a whole continues to outpace the Warsaw Pact by a factor of 2 to 1 (and this ignores Japan's GNP, now on a par with the USSR).

The Kremlin, however, continues to stress armaments at the expense of all other sectors of the economy. As a result, one of the more dismal aspects about the East-West military balance is the sheer amount of combat equipment rolling off of Soviet assembly lines (e.g., some 6,000 tanks and other armored vehicles, 2300 artillery pieces, 650 fighter/bombers, 500 helicopters, and 8 submarines annually). The Soviets can mass produce and replace military equipment on a scale very difficult for the U.S. and its industrial allies to match. Moreover, each new generation of Soviet weaponry is more capable and more sophisticated than the last.

As implied earlier, however, there is an internal downside to heavy Soviet military production. Concurrently, the Soviet Union is struggling to overcome weaknesses endemic to its state-run system: the difficulties of running a "command" economy with no measure of profit and loss, depletion of its European mineral base, challenges of developing alternative resources in Siberia, lack of discipline among workers, management shortcomings revealed in the Chernobyl disaster, and a host of problems keeping political and economic relations with Eastern Europe on an even keel. Their intense arms efforts exacerbate these problems and at a minimum impede their correction. This fact alone may be behind some of the initiatives we are seeing in the arms control arena.

In essence, it is far from clear that the Soviets will be able to continue their present practices, achieve their long-term industrial goals, and outfit their entire military force with front-line equipment now coming off their assembly lines--or that they will be able to do so without trimming back on force structure. Suffice it to say, this remains a major uncertainty for them and for us.

STRATEGIC NUCLEAR FORCES

With respect to the strategic balance, our primary concern is to maintain strategic parity with the Soviet Union. In and of itself, that's a major challenge because the Kremlin continues to finance a robust and forward-looking program to improve both strategic offensive and defensive forces.

Overall, the USSR continues to maintain superiority in ICBMs and overall megatonnage. They are steadily improving ICBM survivability with both hardened silos and mobile launchers. With extensive land, roadways, and railways under constant state control, ICBM mobility is an area where they can strive for a competitive advantage over the United States. Our PEACEKEEPER missiles, however, still confront them with a formidible hard-target kill capability--which can be made rail-mobile, if we so choose.

With respect to ballistic missile submarines, the Soviets continue to find themselves at a disadvantage. They remain behind us in missile-launching capability, and they continue to worry about our superior ASW capabilities. As a consequence, the

Russian Navy is deploying the bulk of its SSBNs near home waters where its own ASW forces can offer more protection and where permanent and marginal ice zones can complicate opposing ASW operations.

The main difference, of course, is the stealth, endurance, and firepower of our nuclear attack submarines. We can, if we choose to do so, hold Soviet SSBNs at risk. In contrast, the Soviet Navy has never developed an open ocean ASW capability sufficient to challenge our POSEIDON and TRIDENT class SSBNs. Put simply, our ballistic missile submarine forces is less vulnerable than the Soviets.

Moreover, we have a more effective bomber force still capable of penetrating the USSR. The President's strategic modernization program if fully implemented--MX, D-5, B-1, ATB, ACM, and C3 initiatives--will prepare us for the long-haul, keep pace with Soviet improvements offensively, and correct our more-glaring deficiencies.

On the other hand, Moscow continues to outpace us in the construction and fielding of strategic defensive systems: hardened command posts, the Moscow-centered ABM system, an (illegal) phased-array radar extraneous to the Moscow system, a robust capability to replace satellites, and the world's only operational anti-satellite weapons systems.

With all of this, however, the Kremlin seems genuinely concerned about our Strategic Defense Initiative. It's not what we have today but what we might have tomorrow that concerns them most. In my view, we would be wise to nourish that concern.

Thus, all things considered, I am relatively confident that strategic forces and programs which are being proposed will continue to deter a direct nuclear attack on the U.S. and our allies. But I must reemphasize, for that judgment to continue to be solid, it is imperative to stay the course with our strategic modernization programs.

MARITIME DEFENSE

On the maritime front, the Soviets operate the largest Navy in the world, tailored primarily for wartime sea denial missions, i.e., about 2000 kilometers out from the Soviet homeland. At the outer edge of this zone, they are depending primarily on their nuclear attack submarines and their long range maritime strike aircraft (BACKFIRES). Additionally, we can expect some of these submarines to deploy further afield for anti-SLOC, anti-SSBN, or anti-carrier operations.

A significant challenge on the high seas is growing out of the Soviets' success in:

- o Deploying very advanced anti-ship missiles which are constantly improving;
- o Adding to their over-the-horizon targeting capability by exploiting space;
- o Improving submarine propulsion (speed and quietness) and metallurgy (depth); and
- o Increasing ASW capabilities.

Throughout the immediate postwar period, the U.S. enjoyed undisputed mastery of the seas, but the Kremlin was not easily discouraged. By the late 1970's, the Russian Navy had made tremendous inroads into our margin of superiority and the trends were even more alarming. We have now reversed these curves--particularly in overall shipbuilding--but the Soviets are on the high seas to stay.

With a less than 600 ship Navy, we are hard-pressed to challenge Soviet sea denial zones and maintain essential communications lines to allies in Europe and Asia. Clearly, the key to success lies in the full integration of capabilities resident in our carrier battle groups, nuclear attack submarines, maritime patrol aircraft, surface action groups and replenishment units--plus strong support from the allies in terms of choke point control, mine clearance, land-based tactical aircraft, and especially naval escorts. If all of these forces can be brought into play--that's a big if--and we can avoid future force structure cuts, the odds are that the U.S. and its allies can gain ultimate control of the vital sea areas and that the U.S. can proceed with the necessary reinforcement and resupply of forward-deployed forces. I must reemphasize, however, the margins in the calculations are thin.

In essence, we cannot afford to relinquish naval superiority to the Soviets. To do so would jeopardize our coalitions, economic and trade dependencies (which are now necessary in war as well as peace), and capabilities to project our power overseas. Our ability to prevail at sea is a cornerstone of our overall strategy.

STRATEGIC MOBILITY

Today, the Soviet Union is our only real competitor in the business of strategic mobility and, it is likely to remain so for the indefinite future.

Where they can achieve direct, short-haul access, as on the flanks of NATO and parts of Southwest Asia, the Soviets maintain a strategic mobility advantage over the U.S. Yet, that is where we may very well be taxed to move ground and air reinforcments rapidly in support of U.S. and allied security interests. Our aim, of course, is to meet this challenge with a robust mix of strategic airlift (C-5, C-141, and C-17), supported by the Civil Reserve Air Fleet.

Outside the Warsaw Pact area (including Soviet territory) and Afghanistan, the USSR has never staged a large-scale strategic mobility exercise, i.e, involving the movement of thousands of troops and supporting combat equipment by airlift and sealift over long distances. Even if they could muster the necessary airlift, it is far from clear that they could achieve the precise coordination and timing necessary to carry out an operation of this kind smoothly and quickly.

In contrast, our Transportation Command has years of global mobility experience as a result of its day-to-day logistics support of our forward deployed forces and its participation in our worldwide exercise schedule--plus an established routine of working with other nations to acquire the necessary staging rights. Thus, in terms of both assets and experience, I am convinced that Soviet lift capability is outmatched.

One area of concern is a general decline in the number of merchant ships suitable and available for the defense of NATO Europe, e.g., capable of lifting heavy equipment, military supplies and troops. In the meantime, many of the allies are shifting flags or crews to other nationalities.

On balance, though, we have made impressive strides with our strategic mobility forces. Given the world we live in and the nature of our commitments, we must continue to do so. The main question in using such forces is whether we will move soon enough in a crisis to take full advantage of the edge our capabilities give us.

SPECIAL OPERATIONS FORCES

It is very difficult to compare Soviet "SPETSNAZ" directly with Special Operations Forces (SOF) of the United States. Moreover, the Soviets have been rather cautious about employing their own SPETSNAZ against U.S. interests. It is much easier for Moscow to funnel support for subversion and terrorism through surrogates in Eastern Europe, the Middle East, Africa, and Latin America--and then deny responsibility for the whole business.

When circumstances dictate, however, the Kremlin finds SPETSNAZ forces well suited for military purposes, for instance in Czechoslovakia and Afghanistan.

In the meantime, we are continuing to train and equip Special Operations forces for global missions. Some of these tasks will be in direct support of Commanders of Unified Commands. Others of a time-urgent or politically-charged nature will be controlled from Washington.

The SOCOM headquarters is well established and now making its influence felt throughout the special operations community. General Lindsay has established a close working relationship with all of the unified commands and has launched an ambitious program of exercises to test the quality of his training and SPECOPS planning.

In Secretary Carlucci's Annual Report to Congress, you will find a full treatment of efforts to enhance SOF preparedness. Suffice it to say, the force is receiving a great deal of top level attention while continuing to demonstrate its unique value in both low intensity conflict and conventional conflict.

WESTERN HEMISPHERE

Turning to regional assessments, security of the United States--and approaches thereto--ranks number one in our national security priorities. In the neighboring Caribbean Basin, U.S. goals have remained remarkably constant over time: i.e., promote democracy and free market forces, develop local economies, and eliminate widespread poverty. Yet, no one can be comfortable with what has happened in that region since the end of World War II.

Granted, we find a number of friendly governments achieving or moving toward pluralism. But we also see a heavily-armed Cuba and Nicaragua constantly working to derail free and democratic processes in the region--joined at times by groups engaged in the illegal distribution of drugs. Overall, the military balance in Central America is patently adverse for the smaller democracies--and it is likely to remain so for the foreseeable future.

Given commitments in other parts of the world, the U.S. relies heavily on military assistance programs to shore up peace and stability on its southern flank. In and of itself, those programs can make a crucial difference to people reaching not only for social progress, but also a modicum of national security and personal safety.

In a practical sense, these programs serve to enhance regional intelligence networks, extend the in-country reach of local armed forces, improve the effectiveness of these forces through training and exercises, and encourage the growth of sub-regional collective security arrangements. Further, virtually every dollar funded for Central American military assistance programs (equipment and training) remains in the United States--thus serving to boost both our security and our economy.

To be frank, I am concerned about the military situation on our southern flank. Termination of military aid to the Contras is going to leave the Sandinistas of Nicaragua with a much freer hand to pursue their own political agenda and, in my view, work against pluralism in the country and peace in the region as a whole. Concurrently, Congress has severely constrained the U.S. military assistance program by reducing funds for the program as a whole and skewing priorities to other parts of the world. Overall, these decisions are bound to raise the level of risks in the region not only for America but also for people who look to us for security support. It is not a healthy situation.

NATO/WARSAW PACT

Ever since formation of the North Atlantic Alliance, the pace and effort required by NATO to maintain a credible deterrent and viable defense have been driven by a steady expansion of Soviet capabilities.

Moscow has always emphasized numbers, ground forces, and frequent modernization of weapons systems. With the passing of time Warsaw Pact superiority in conventional units and weapons steadily grew and today it leads NATO in virtually every category by ratios of 1.5 to 6 to 1. Moreover, our initial qualitative edges in some ground systems have eroded--for example in anti-armor missiles, surface-to-air missiles and artillery. This progress has been matched by the creation of an impressive Soviet air-order-of-battle as well--again outstripping NATO numbers.

The most dramatic changes, however, have taken place in the Soviet nuclear stance. Moscow first gained strategic parity with the U.S. and then proceeded to surpass Washington's lead in theater and battlefield nuclear systems. These developments were complemented by the deployment of a significant chemical capability.

From the outset, it became clear that the U.S. and its allies could not match Warsaw Pact numerical advantages in forces and weapons systems. Instead, the coalition reacted by adopting a "defensive" philosophy which aimed to keep the Soviet level of "uncertainty" high enough that the Kremlin could not have the desired confidence of achieving its objectives. At first, the U.S. nuclear advantage buttressed such a doctrine. But as increasing numbers of Soviet nuclear weapons appeared, the Alliance turned to a "flexible response" strategy with emphasis on quality forces and sophisticated weaponry across the spectrum from conventional, to theater nuclear weapons, to strategic forces.

As a consequence of these policies, conventional force modernization has for two decades been a significant theme in the NATO defense planning process. In the 1970's, for example, much of the groundwork was laid for a new generation of tanks and fighting vehicles, tactical aircraft, anti-tank missiles, and smart munitions, coupled with greater standardization and interoperability and better integration of combined arms. The U.S. has been in the forefront of this effort--particularly over the last 8 or 9 years. As a result, our forces in Europe have steadily improved in infrastructure, equipment, sustainability, combined arms training, personnel, and night-fighting capability. In general, Soviet military power today is less coercive and less dangerous than it might have been.

The NATO qualitative edge in tactical aviation while somewhat diminished has not disappeared. It is not clear, however, what this will mean against the numerical advantages of the Soviet air forces (offensive and defensive) which run in the neighborhood of 2:1 to 3:1. I have complete confidence that the quality of our pilots and weapon systems would permit us to exact high exchange ratios but overcoming the impressive numbers of Russian medium-range bombers, fighter bombers, interceptors, and surface-to-air weapon systems will be a sporty course. The outcome is difficult to predict.

We will, of course, have the support of our naval forces in Europe and, as indicated earlier, the Soviets have yet to surpass our lead at sea.

Time and space doesn't permit me to detail all of the factors that our warfighting analyses take into account. I can assure you these assessments go behind the numbers and attempt to evaluate a wide variety of inputs including Soviet personnel weaknesses, Moscow's reliance on satellite troops, logistics demands, intangibles such as morale, etc. The bottom line is that NATO capabilities are still deterring in Europe. Surely the prospect of having to fight 16 nations at once remains a sobering one for the Kremlin. But, put candidly, both the level of deterrence and the nuclear threshold remain too low. The Chiefs have for a number of years consistently testified to that effect.

If for some reason war breaks out, maintaining a successful forward defense will be questionable. Our analysis argues strongly that Soviet conventional ground forces will be extremely difficult--if not impossible--to contain. Especially worrisome is a pronounced Soviet advantage in chemical warfare capabilities. Even if they could be defeated--and this is very controversial--it would be at a prohibitive cost in lives, treasure, territory, and stability.

It is imperative for the Alliance to preserve the gains made in the 1980s and move forward with programs which will promote a high degree of uncertainty in the minds of Kremlin planners. In this regard, the INF Treaty will exact a favorable exchange ratio in theater nuclear weapons. That Treaty stands on its own merits and should be ratified. It will not, however, correct the deficiencies I refer to. The level of risk is too great today and, unless some other counter-actions are taken, it will still be too high after the INF Treaty is implemented.

The fundamental challenge is to disrupt the Soviet timetable for overrunning NATO territory. As indicated during my testimony on the INF Treaty, that thought is at the center of DOD's work on long-term competitive strategies. The proposed solution would enhance and supplement the cutting edge of NATO's existing forces with terrain barriers, a new generation of highly-accurate stand-off missiles, and improved battlefield and rear area surveillance systems.

Concurrently, it is essential for the NATO members to correct other deficiencies identified in the study of Conventional Defense Improvements and, in keeping with the Montebello decisions, move forward with the modernization of theater nuclear forces allowed by the INF Treaty.

SOUTHWEST ASIA

In the Southwest Asia region, the military situation remains highly dynamic and uncertain. We still do not know what will come out of the eight-year war between Iraq and Iran and, standing on the sidelines, are 32 Soviet divisions facing Turkey and Iran, plus 115,000 Soviet troops still occupying Afghanistan.

Within the Persian Gulf itself, Iran has long-term advantages over the other Gulf states as a result of a large population, diverse resources (not limited to oil), a long coastline, and a network of air and naval bases. As we have seen in the Iraq-Iran war, the radical Islamic fundamentalist regime is exploiting these strengths. If the Iranian regime was ever to conclude the current hostilities on favorable terms and move toward internal stability, it could easily become a genuine threat to its Gulf neighbors.

The United States interests revolve around petroleum and maintaining its traditionally close relationships with the western-oriented oil bearing states in the Gulf. Those nations will be important players in the Free World economy for the foreseeable future and U.S. influence in the region is vital to our long-term economic health. It is these very considerations which inspired today's operations in the Persian Gulf.

Our current deployments in the region have demonstrated that we have sufficiently mobile naval and air strength to deal with the most likely contingencies in that part of the world and to protect our interests where only Gulf states are involved.

In the unlikely event of a Soviet thrust to the Gulf oil facilities, this would precipitate an international crisis of the first order and in my view involve not only the entire Free World but quickly raise the level of risk in the other areas where we have even more basic interests. The response would of necessity have to be a multilateral one.

PACIFIC DEFENSE

My assessment of the Pacific region has changed little since last year. Until the late 1960's, Moscow paid little attention to the defense of its eastern provinces and its strength in the Western Pacific. With the PRC's breakaway from the Soviet orbit and the burgeoning affluence of East Asia, the Kremlin began to build up its forces in the region, not by drawing down in Western Europe, but by commissioning new units and increasing defense production to equip and support them.

Overall, the balance on the Chinese border favors the Russians in every way except manpower, and as yet the Chinese have been unable to turn things around--preferring to put their current priorities elsewhere. The one exception is Chinese nuclear capability which provides "minimal deterrence" of a sort.

Nevertheless, China looms large in the Kremlin's calculations--witness the gradual buildup from 20 to 50 Soviet divisions on the Chinese border.

On the Korean Peninsula, Pyongyang has made a determined effort to outstrip the South's forces. However, as long as North Korea is not directly assisted by the Soviet Union, United States augmentation--especially our air and naval power--should make the difference in deterring or, if necessary, defeating the North. The fact remains, however, the Peninsula is an unstable focal point with a threat of war always lingering on the horizon.

In turn, the defense of Japan and the Republic of Korea and the wartime stance of China depend heavily upon the military role and posture of U.S. forces in the Western Pacific. We have significant leverage against Soviet naval and air forces in the region which both reduces the threat to our sea lines of communication and constrains the Kremlin's ability to accomplish its strategic goals in the Far East.

What happens in the East Asia and Pacific region also has major implications for NATO, in that a faltering defense by the U.S., Japan, or China could enable the Soviets to divert substantial air and ground forces to the European theater.

Generally, political relationships in this region work in our favor. It is clear that PRC forces tie down substantial Soviet ground and air deployments in the region and that Beijing puts considerable stock in U.S. power deployed in the region. In a similar vein, Japan is a pillar of U.S. strategy in the Pacific. Without Japanese cooperation, it would be difficult to bottle up the Russian fleet, augment South Korea, and find sufficient bases to support continuing operations against the Soviets. Likewise, the health of the U.S.-Philippine relationship, politically and militarily, impacts heavily on the regional balance. Obviously, the firmness of U.S. alliances will rest to a great degree on our ability to successfully confront the Soviets in the region and, in the event of war, to keep open our sea lines of communication to the Western Pacific.

Today, I judge the posture of U.S. and allied forces in the Pacific sufficient to deter the Soviets from a major attack in that theater and, if deterrence fails, prevent them from achieving their military objectives. The Republic of Korea--with Washington's support--is similarly equipped to deal effectively with any threat from the North that does not involve either the USSR or PRC. I am inclined to believe that any U.S.-Soviet confrontation in the Pacific would take its lead from Western Europe or elsewhere.

Looking ahead, however, long term deterrence in the Pacific will depend heavily on a general upgrade of regional air defenses, (from Alaska through the Korean Peninsula), the introduction of long range interceptors and attack aircraft, and C3I which can optimize employment of U.S. and allied tactical air forces.

SUMMARY

In summary, it is clear that the investments made in the last few years have materially improved the foregoing net assessment from the U.S. standpoint. It is equally obvious that the picture is a dynamic one, that the Soviets are working diligently to improve their position across the board, and that there are still a number of serious gaps in our own posture. On balance, we need a number of years' growth before we can face the future with confidence--the kind of confidence that befits the leader of the free world.

FY1989 DEFENSE BUDGET

Now to the defense budget. In real terms after inflation, Congressional appropriations peaked at $286 billion in FY1985 and then declined by 10% through FY1988. In keeping with the Budget Summit Agreement of last November, the President is requesting $299.5 billion in FY1989.

The Chiefs and, to an unprecedented degree, the CINC's participated in the formulation of the budget and, while it is by no means risk-free, they are satisfied that, on balance, appropriate compromises and trade-offs have been struck at the resource level which has been set by the Budget Summit.

It should be noted that this budget has been carefully and tightly constructed to fit within a firm pre-set commitment and that there is a careful interlocking of the constituent elements. It is imperative that the topline figure be honored and that the structure of the submission be kept basically intact. The budget elects a slightly smaller force in order to protect quality throughout and strives to protect our ability to fulfill alliance commitments.

Its main priorities, as set forth by Secretary Carlucci, are people, readiness, and efficient acquisition. The budget is faithful to those goals. Secretary Carlucci's statement has addressed each of these areas in detail. Consequently, I will only mention some of the more significant items.

BUDGET CONTENT

The most precious assets the Services have are people--trained and skilled people. In times of stringency they become even more important, because we traditionally depend on our personnel to compensate for drawdowns. You will note that, throughout, the proposed budget protects quality-of-life items, military training facilities, combat exercises, and readiness items (e.g. flight and steaming hours)--all of which directly affect morale and retention curves.

By any common sense measure, today's armed forces are sound and motivated. In fact, everyday performance, spirit and training are the best I have witnessed in over forty years of service. If necessary, we can drawdown force structure but the Chiefs are determined not to let the "quality" of the remaining units deteriorate. Never again do we want to return to the "hollow forces" of the 1970's.

With respect to military capabilities, this budget protects those which only the U.S. can provide for itself and for allies who depend upon us, i.e., a secure nuclear deterrent; maritime superiority (especially ASW capability); strategic mobility for U.S. ground, air, and naval forces; unique skills and equipment required by special operations forces; and associated command, control, and communications capabilities.

Additionally, the FY1989 budget was structured to:

o Provide a 4.3 percent pay raise for our military personnel effective 1 January 1989;

o Maintain our defense industrial base at efficient levels of production for essential systems, while continuing to build-up stocks of force-multiplier munitions;

o Sustain spare parts and low-technology munitions backing U.S. formations at about current levels. We will not be surging substantially ahead of allies in Europe and Asia;

o Support a 2.4 percent real growth over FY1988 in operations and maintenance, keyed to operational tempo improvements and increased depot maintenance efforts;

o Keep pace with mission essential and quality-of-life military construction projects; and

o Procure hardware and continue R&D programs supportive of NATO conventional and theater-nuclear force improvements, i.e. endorsed by the Montebello agreement and permitted under the INF Treaty.

In order to protect these capabilities, we were forced to cut back in a number of ways.

Conventional Forces

With respect to conventional force structure, virtually all of the reductions will occur in our CONUS-based strategic reserve. We were led to this decision by two factors. First, it is the sense of Congress that we should try to maintain permanently-stationed forces in Europe at current levels. Second, Secretary Carlucci directed that the Services consider a smaller higher quality force. Most of the units with obsolete and hard-to-maintain equipment are located in the United States, not in Western Europe or Northeast Asia.

As a result, the U.S. strategic reserve will be reduced by:

o Some 35,917 active duty military personnel, and 30,884 civilian personnel from FY1987 levels;

o The equivalent of 3 Air Force Tactical Fighter Wings by 1991;

o An Army infantry brigade plus two infantry battalions and 450 older helicopters; and

o Sixteen Navy frigates and 1 carrier air wing.

Additionally, the procurement of conventional military equipment has been cut back by 16% compared with the original budget for FY1989. I will not dwell on the specific program adjustments since they are covered thoroughly in Secretary Carlucci's statement.

Overall, these cost-avoidance measures will have only limited impact on our forward defense posture in Europe and Asia. The industrial allies must understand, however, that our strategic reserve of conventional forces is going down not up and, in turn, become less dependent upon that reserve in their own defense planning.

Strategic and Space Programs

With respect to strategic and space programs, you will find that:

o Procurement of the PEACEKEEPER ICBM has been reduced from 21 to 12 missiles, while funds have been earmarked for development of a rail-mobile version;

o The Small-ICBM is maintained as a research and development program as opposed to accelerated deployment;

o Planned funding for the Strategic Defense Initiative has been cut by 28%;

o A high priority was placed on sufficient expendable launch vehicles (TITAN IV) to support satellite deployment requirements; and

o The ASAT program has been terminated.

On balance, the budget preserves options to deploy land-mobile missiles and ensures that we will maintain a space-launch capability sufficient to support our peacetime military requirements. It has, however, reduced our investment in some programs which could provide a better balance between strategic offensive and defensive capabilities and provide important insurance options for the future.

RISK ASSESSMENT

With respect to risks, the FY1989 budget recognizes that a coalition strategy has become more--not less--important to the United States. Similarly, it was structured to preserve and optimize U.S. contributions to the collective security of NATO Europe and our allies in Asia. We are not well positioned, however, to fill the gaps if, for one reason or another, some of the allies decide to reduce defense spending levels, shed defense commitments, or trim back on conventional force improvements.

Four years of negative growth in U.S. spending for defense is just beginning to play out in terms of reduced military capabilities. Simply put, this year's budget manages to limit short-term risks by relying on yesterday's programs and nourishing some of our more promising R&D efforts (SSN-21, ATA, ATB, ATF, FAAD, etc.). We cannot, however, begin to field these new systems--or avoid further precipitous cuts in force structure--unless Congress provides the necessary resources.

In essence, it is important to understand that this is only the beginning of greater downstream risks in the defense planning and programming process. As others have observed, several years of negative growth in defense spending inevitably will lead to dangerously reduced capabilities and force structure. We should learn from our history. Four times in the last 100 years we cut back precipitously in peacetime and then entered major conflict dangerously unprepared. In each instance we paid a needlessly high cost in treasure, lives, and stability.

Of particular concern is the impact of cost-avoidance measures on our people. We are not cutting back on commitments. Yet we are asking our military personnel to take up the slack resulting from modest but nonetheless real cuts in force structure. Congress can do a great deal to ease this transition by ensuring that our military personnel remain confident in laws governing military compensation, including the benefits of active duty and the integrity of our military retirement system.

DOD REORGANIZATION ACT OF 1986

Before wrapping up my statement, Mr. Chairman, a few words are in order about the DOD Reorganization Act of 1986.

As a result of the Act, I am much better positioned to solicit, integrate, and weigh views of the Joint Chiefs of Staff, Commanders of the Unified and Specified Commands, and Directors of the Defense Agencies--and to guide work of the Joint Staff. Further, I am most encouraged with the quality of personnel assigned to the Joint Staff and the support I am receiving on some very complex and thorny political, military, and operational issues. Concurrently, real progress has been made in the area of resource analyses and net assessments. Overall, we are steadily improving our ability to integrate defense resources and warfighting capabilities.

Additionally, we are striving to achieve excellence in joint professional military education at the National Defense University and at Service Colleges. As the academic and accrediting process evolves, I am confident that we will do so.

Of immediate concern is Title IV as it pertains to officer personnel management. It is becoming increasingly clear that joint tour lengths mandated by Title IV will work against the balanced officer experience we seek and need in joint command and staff billets. Too little operational experience can be just as bad as too little joint experience. Thus, we will again be proposing to reduce the minimum joint tour length for O-6 officers and below from 3 1/2 to 3 years and for general/flag officers from 3 to 2 years. I cannot overemphasize the importance of this request, if we are to maintain healthy personnel structures in the four services.

Additionally, we are bumping against very compressed time lines in the preparation and assignment of officers to some 4500 important billets requiring joint specialty officers or nominees for the specialty. As the situation now stands, we face a surge of shorter than planned tours in non-joint positions, an adverse rippling effect throughout our officer manpower structure, and higher personnel relocation costs in a fiscally-constrained environment. Thus, we will be proposing that the transition period for Title IV be extended from 1 October 1988 to 1 October 1989.

The foregoing changes to Title IV would be in the best interests of officers seeking to become joint duty specialists, of our combatant commands, and of our armed forces in general.

CONCLUSIONS

To conclude, it is clear that investments made in the early eighties have from our perspective improved the global military balance. However, the Soviets have not slackened their efforts and the threat remains an imposing one. The fact that we still have serious gaps in our own posture combined with 10% negative growth in security appropriations since 1985 will inevitably push the level of risk higher. If this trend continues we will be forced not only toward further drawdowns in force structure but also cutbacks in quality which this budget has worked hard to avoid. In that event many of the gains we have made in the 1980's would unravel and the risk would escalate precipitously.

Shaping a FY1989 budget constrained to no real growth proved to be a challenge for everyone in the Department of Defense. We are depending heavily on Congress to approve the overall shape and content of this budget. Substantial changes in the fundamentals or even at the margin may very well weaken the entire submission.

We have for this one year provided for short-term concerns, but put aside the challenges and cost of preparing for long-term military competition with the Soviet Union. Believe me the race will not go away just because we would prefer to save money. We are engaged in a security marathon and it would be folly to conclude otherwise. Thus, the Joint Chiefs of Staff strongly concur with Secretary Carlucci's conclusion that we should aim for 2% real growth in the biennial FY1990-91 budget submission.

Chairman **Chiles**. Senator Exon.

Senator **Exon**. Thank you very much, Mr. Chairman, and welcome, gentlemen.

I want to associate myself with the remarks made by the chairman and the ranking member, saluting you for a job extremely well done under difficult circumstances.

Well over a year ago, I wrote the then Secretary of Defense, outlining the fact that from my perspective, I was very fearful that the next administration would inherit a totally bankrupt military policy, given the look-see into the future with regard to constraints on the budget. It would have been very easy, Mr. Secretary, I think, for you to come into office in the last year of this administration and simply stretch out programs. I did not think you would do that, and I was delighted with the fact that you came under the most difficult challenge, I think, of any Secretary of Defense who has ever come in, and you have met that challenge, and I salute you and the other members of the Joint Chiefs, Admiral, for recognizing the realities of the situation. And while there are going to be some differences on down the line on some programs, I think you have done an outstanding job overall, and I just want to say that for the record.

There are several things I would like to go into, but first on burdensharing. There is not any question in my mind and I think in the minds of most of the Members of Congress that particularly our NATO allies and our Japanese allies are not doing what they should in this particular area. But at the same time, having said that, I want to salute this administration for making some very important strides upward by commitment on the part of the Japanese, I think somewhere in the area of 5 percent real growth a year.

Now, that is still very small, but percentages tend to fool you. It should be more than that. But I want to suggest that that was done successfully primarily by negotiations and agreements at the highest levels of government, not openly in the press by us bashing the Japanese more than the statements from time to time that they should do more.

I believe and hope and suggest that the same policy be followed with the NATO allies to get them up. And I guess, while I think they are not carrying their share of the burden now, I am very much concerned about what I believe has been the successful effort on the part of Mr. Gorbachev to carry on an excellent public relations policy. NATO bashing at this particular time is not the way to solve the problem, but I hope the message delivered very clearly by both of you to your counterparts over there, and by the President to his counterparts in NATO, that we need more help.

Could you have a little order, Mr. Chairman?

Chairman **Chiles**. Yes, sir.

We were just simply trying to remember what the question was. [Laughter.]

Senator **Exon**. Thank you, Mr. Chairman. I did not make an opening statement when the hearing began.

Mr. Secretary, I want to also compliment you on your MX/Midgetman stand.

I would like to enter in the record if I could at this time, Mr. Chairman, a letter that I just received from the Secretary regarding this.[1] It corrects, I think, the rather erroneous impression that appeared in the news media a few days ago about Secretary Carlucci making a significant change or reversal, if you will, in his position.

I take it that that is not your intent at all, and you are not doing that, and I compliment you for it.

I remember well, way back in 1981 when the decision was made to put the MX in Minuteman 2 and 3 silos. I felt that was a tragic mistake at the time, and I think the movement out on rail garrison is fully worthy of the suggestion that you have made.

The question I have in this regard, just to clear this up once and for all, is I suspect, Mr. Secretary, that if you were in the first year of an administration as Secretary of Defense and not the last, that you would probably hold firm to your initial decision to zero out funding for the Midgetman, rather than to apply the $200 million to that program for the fiscal year 1989, simply because being realistic and understanding, you are simply saying that while you think the program should be scrapped, and we cannot afford it, you are leaving the door open for the next administration to make the final decision on that, rather than slamming the door shut now.

Secretary CARLUCCI. That is correct, Senator Exon.

Senator EXON. Let me ask one other question about the planning that you and others have done with regard to the whole series of yet unrevealed programs that we have that are going to be tremendously expensive from the standpoint of procurement and full research and development.

Were those programs that you know are going to be coming on line sometime in the early 1990s factored into the budget preparation for the outyears as we move forward?

Secretary CARLUCCI. Yes, to the degree that we were able to do that, Senator Exon, in the 5-week period. We were operating off of the old FYDP in the 5-week period. We were unable to complete or redo the FYDP. We are now going through that exercise in conjunction with the 1990 budget. So I cannot say with certainty that we have scaled every program down to the new 2 percent top line.

Indeed, my own judgment is we will probably have to take some more programs out the FYDP, but I cannot tell you exactly how much at this point. But the programs you are referring to, if I understand what you are talking about, will be protected, and they are funded in the outyears.

Senator EXON. I am just saying with only a 2-percent increase, that even amplifies more the fact that we simply cannot afford to proceed with the development of two missile programs, and the Midgetman and the MX, and have room leftover under those constraints, in my view, to do the necessary things that we are going to have to take a look at during the future years with regard to the programs that we are now developing.

It is going to be an extremely difficult choice, and that choice is maybe going to be even more difficult for those who follow you if we continue with too many expensive, $40 and $50 billion programs in the overall budget.

---

[1] See p. 129.

Secretary **Carlucci**. Yes, I quite agree with that. I should emphasize that while I have put $200 million in the 89 budget for Midgetman, there is no money for Midgetman in the outyears. That is the one instance of a program in this budget that is not funded in the outyears.

Chairman **Chiles**. Senator Nickles.

Senator **Exon**. And you did that only because you felt that was the right thing to do, since this may be your last year in office?

Secretary **Carlucci**. I was told by a number of people that there was a mutual suicide pact here, and that I would be responsible for killing the land-based leg of the Triad if I were to kill Midgetman, and I thought that that was a personal responsibility that was a little heavy for me to bear in the last year of an administration, so I agreed to put some funding in.

Senator **Exon**. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

[The following letter was submitted for the record by Senator Exon:]

THE SECRETARY OF DEFENSE
WASHINGTON, THE DISTRICT OF COLUMBIA

1988 MAR -2 AM 8 58

1 MAR 1988

Honorable J. James Exon
United States Senate
Washington, D. C. 20510

Dear Senator Exon:

I appreciate your interest in asking that I reiterate my position on deployment of the Peacekeeper missile. I support deployment of all 100 Peacekeeper missiles in the Rail Garrison system. It is the best option.

The amended FY 1989 budget request has been prepared assuming Rail Garrison basing. Since Initial Operating Capability for Rail Garrison is not until 1991, however, the ultimate decision on whether to proceed will fall to the next administration. It is in this sense that I have tried in the hearings to remove any characterization of the amended budget as a final "up or down" vote on Peacekeeper basing. The monies requested in the amended budget will enable us to progress with Rail Garrison to the point that I hope both the next administration and the Congress will endorse the recommendation I am making.

Sincerely,

Chairman CHILES. Senator Nickles.

Senator NICKLES. Mr. Chairman, do we have a 5-minute rule, or the usual 10?

Chairman CHILES. We are trying to hold to 5 minutes.

Senator NICKLES. I understand.

Chairman CHILES. It doesn't apply to former Governors.

Senator EXON. I am finally getting a little respect. [Laughter.]

Senator NICKLES. Mr. Secretary, today, at Tinker Air Force Base, 830 employees are receiving notice that they will be terminated on March 19. Another 18,200 workers at Tinker Air Force base have been notified that they will be furloughed for up to 10 days between April 1 and October 1.

I talked to the commanding general of the base and asked him about the work and the services that are provided. They still have to maintain the B-52s; they still have to maintain the other aircraft. He said their workload is increasing and continuing. It has not decreased one iota. He says he needs these people. He says they are providing a very valuable function for the Air Force and that, really, we need to work to correct it.

I have talked to you on one or two occasions in the past. I have talked to Secretary Aldridge and asked him what could be done. I want to work with you to solve this problem. I really don't want these planes flying when they are not safe, or I don't really want them not to be able to fly because they are not maintained, and therefore we don't have the readiness available.

I think it is important national security issue; it is not just jobs. It is a national security issue that is at stake.

I don't want to get into, as Admiral Crowe mentioned in his statement, the seventies, when we found ourselves a little hollow, that we did not have planes and ships to go.

In discussing this with you and Secretary Aldridge, you have mentioned the possibility of increasing your ability to be able to transfer funds, up to $4 billion in funds, I believe.

I am in the process of introducing legislation and getting some cosponsors on that legislation right now.

I notice on page 28 of your testimony, you state 1988 unfunded requirements that equal $4 billion. I do not see anything in there for operation and maintenance, logistics centers, or anything else. If we are able to enact this legislation which would give you greater flexibility in being able to transfer moneys between various accounts, would you be able to solve that problem and move some money into operation and maintenance? Is that a priority item?

Secretary CARLUCCI. Senator Nickles, the situation is complex. First of all, we need to be clear why these reductions are coming about. They are coming about because of congressional reductions in the O&M account in the fiscal year 1988 budget.

I have tried to restore the O&M account in the 1989 budget. In other words, I have taken it back up to the old level so that if the Congress votes the budget we request, we will not short-change readiness, because I quite agree with you our highest priority is to maintain readiness. We do not like to have to take these measures.

But that account has in it not only the salaries of these people, but readiness, sustainability, depot maintenance—all the things that relate to readiness. There just is not enough money in the account.

I have requested that our transfer authority be increased from $1.5 billion to $4 billion, to accommodate this and other urgent requirements. And as you have seen in my testimony on page 23, these include CHAMPUS.

The CHAMPUS increase alone will chew up the $1.5 billion transfer authority that we currently have.

Senator NICKLES. And on page 28, which shows the unfunded requirements, I see a lot of different things including CHAMPUS, but I do not see any money for operation and maintenance.

Secretary CARLUCCI. No. We would put some of the money under the transfer authority into the O&M account. Also, we are asking for not only transfer authority, but we are asking for authority to use expired procurement and R&D accounts to fund the foreign exchange fluctuation fund.

So if we get that, that would take some of the burden off.

Senator NICKLES. I will try and help you on that.

I see my time is about up. Let me just make one other comment in followup to Senator Exon's comment. Leaving $200 million to leave the door open for Midgetman, in my opinion, you can leave the door open for Midgetman, and you do not have to spend $200 million. Now, I think that decision can easily be deferred, but I just question the wisdom of spending $200 million.

I also would make one comment concerning ASAT. I understand that Congress has prohibited the testing of ASAT, but I hate to see the administration not request it. I think that is admitting defeat before we lose. And again, it is important. As you mentioned in your statement, the Soviets do have an ASAT system; they are developing it, and they are improving it, and I think it is absurd, and I hate to see the administration not request funds for that.

Chairman CHILES. You can comment if you'd like.

Secretary CARLUCCI. Well, the only comment on ASAT is—first of all, on Midgetman, we do require some funds to keep the line going, and certain elements will be stopped at points where they could be started. So some money is required.

Senator NICKLES. $200,000,000?

Secretary CARLUCCI. Well, that is down from a projected $1.2 billion in the original 1989 budget, so we have taken $1 billion out of the program.

Senator NICKLES. Do the Chiefs concur——

Chairman CHILES. Well, I'd like to let him answer the question, but we are trying to let other members have a chance.

Senator NICKLES. I understand.

Secretary CARLUCCI. On ASAT, frankly, it is just a question of priorities. Having come up 3 years and been turned down by the Congress, was I to take down another tactical air wing, or two, to come up and be refused permission for testing of ASAT? It seemed to me a better approach would be to try and preserve the tactical air wings, which I can probably get through the Congress, and tell the Congress if you agree with me, I'll go back and find the money somehow in the course of the budget process.

But I fully agree with you; ASAT is tremendously important.

Chairman CHILES. Senator Hollings.

Senator HOLLINGS. Secretary Carlucci, I agree with you, and for the committee, please, or at least for this Senator, because I can use it in the Defense Appropriations Subcommittee, will you list in a letter all that ASAT?

I support you on it, and I want to make a credible move to try to correct that situation because as you indicated, the Soviets do have an operational one, and we have been moving toward one, and I think we can be able to test it when we finally get through.

Secretary CARLUCCI. Senator Hollings, can I give you a letter stating that I will find the offsets? Quite frankly, I have been this route before, and if I list the offsets, they will disappear and I won't get ASAT.

Senator HOLLINGS. Well, I don't want that to occur, but there ought to be some indication because then, in the debate, they will say, well you know, I've got the offset. We get into this zero sum proposition with the Gramm-Rudman-Hollings revisions in there. You have got to find the offsets.

So I'll have to talk to you. I need your help from both of you to try to, as you have used the expression about "kill the leg of the Triad"—I do not want to kill our conventional defense. So I have a reason for asking the question.

Admiral Crowe, I take it you have got provided in this Navy budget 510 sea-launched cruise missiles for $794 million. Is that right?

Admiral CROWE. That is correct, Senator.

Senator HOLLINGS. And you are very pleased with those cruise missiles. They are very effective, and you support that program?

Admiral CROWE. Yes, I do.

Senator HOLLINGS. And when those cruise missiles break the surface, let's say, from a submarine in the Black Sea or up in Murmansk, you cannot tell whether they are conventional or nuclear, can you?

Admiral CROWE. Just from the missile itself, no.

Senator HOLLINGS. That is right, just from breaking the surface, you cannot tell that.

Admiral CROWE. No.

Senator HOLLINGS. But your are delighted, I take it, that that was not included in the prohibition or elimination provision in the INF Treaty; you did not want to include sea-launched cruise missiles in there, did you?

Admiral CROWE. No, sir, we did not.

Secretary CARLUCCI. Let me reaffirm that. I was part of that decision. It is absolutely clear that sea-launched and air-launched cruise missiles are not covered—certainly, they are not covered in the INF Treaty, and our position is that conventionally launched will not be covered in the START.

Senator HOLLINGS. All right. Why did you do it on ground-launched cruise missiles?

Secretary CARLUCCI. Ground-launched cruise missiles did not have the same kind of requirement that we currently have for the sea-launched, the air-launched cruise missiles——

Senator HOLLINGS. Well, let me give the requirements. Here we are, trying to beef up. You cannot get the alliance to appropriate. You cannot get the Congress to appropriate. You are talking about valid programs, and you support them very strongly, but we will not give you the money.

Now, here is a very wonderful program. We have the technology—and you and I know that—to develop a very, very accurate conventional ground-launched cruise missile—so accurate, as you call the CEP, with two meters at the most—with that particular accuracy, it would almost have the same effect as a nuclear explosion. That can really remove targets.

Now, if I took that ground-launched cruise missile and made it conventional and gave absolute inspection to it, verification, there is a signature to nuclear, there is a handling, there is a controlling of nuclear. You can tell the difference on the ground. If I deploy some 3,000 of those around Europe, I could put 500 or 700 down in Turkey, and they are all conventional, and I am lowering the nuclear threshold. I don't have to transmit now from Pershing-II having targeted these targets in the Soviet to sea-launched cruise missiles having to take over or air-launched cruise missiles having to take over those targets. I can take them over with ground-launched cruise missiles, very economically and placed all around, and you can come and inspect them all the time you want, and I will not start the end of the world or World War III.

Now, why include that conventional defense—and it is about the only way we can afford to do it, in all candor; you cannot get through NATO parliaments, and you cannot get it through the U.S. Congress, and I am trying to beef up my conventional forces—why include that in the INF Treaty?

Secretary CARLUCCI. Well, it was included in the INF Treaty for purposes of verification.

Senator HOLLINGS. But we have just verified here that the same situation persists with air-launched——

Admiral CROWE. But not—you are talking about the individual missile once it is in the air, Senator——

Senator HOLLINGS. Right.

Admiral CROWE [continuing]. But not in the total verification problem.

Senator HOLLINGS. Oh, yes, We can come and look at them. I can come and look at one, and you can look at one on the ground, and we can look at one that is going up in the air; oh, yes.

Admiral CROWE. No; but a treaty where you are only going down to 50 percent of our nuclear weapons, the possibilities for cheating are rife, when you have a large ground-launched cruise missile inventory. That is the reason the Chiefs opposed that.

Senator HOLLINGS. The Chiefs opposed that?

Admiral CROWE. Yes, they did.

Senator HOLLINGS. One what basis?

Admiral CROWE. On the basis I am explaining.

Senator HOLLINGS. Cheating?

Admiral CROWE. That the Soviets would have more than an ample opportunity to cheat with a ground-launched cruise missile inventory.

Senator HOLLINGS. Well, they are already cheating with an SS-25. We have removed all targets with our removal of the Pershing II. We have removed all targets. They have not lost a single European target with this INF Treaty. They can retarget 25s on every one of those in Europe——

Admiral CROWE. We can do likewise, Senator.

Senator HOLLINGS. Sir?

Admiral CROWE. We can do likewise.

Senator HOLLINGS. With nuclear?

Admiral CROWE. Well, that's what you were talking about.

Senator HOLLINGS. But not with conventional ground-launched cruise missiles.

We have got a superiority of technology and an advantage of technology that you in the Defense Department ought to be yearning for——

Admiral CROWE. And we are planning to take advantage of it——

Senator HOLLINGS. Wait a minute, wait a minute. Let me complete the thought. You do with respect to the Navy; you do with respect to the Air Force, but you won't do it for the ground-launched cruise missile.

Why not?

Secretary CARLUCCI. Well, as I indicated that was done for verification purposes with regard to INF——

Senator HOLLINGS. Well, the purposes are the same. You have just stated that. That is what I got out of both of you.

Secretary CARLUCCI. Well, we can substitute ALCMs and SLCMs. We can bring ALCMs and SLCMs to bear when we need to. And that is——

Senator HOLLINGS. You can bring ground-launched cruise missiles, you can make them conventional, and you and I know that, and the nuclear have a signature and a handling and a control system.

Secretary CARLUCCI. Senator Hollings, I wouldn't argue with you that it is a desirable thing to do, but it is also desirable from a military point of view for us to have the INF agreement. The President made the decision that for verification purposes, all ground-launched cruise missiles would be considered to be nuclear tip.

Senator HOLLINGS. And therefore destroying totally our conventional. That is what you have really done. You worry about that $200 million for that leg of the triad; you had better worry about the ground-launched cruise missile in destroying our conventional, because we canot get enough troops. We know that.

Secretary CARLUCCI. Well, let me be clear on the record here that that does not serve as a precedent for ALCMs and SLCMs in the START agreement.

Chairman CHILES. Senator Symms.

Senator SYMMS. Thank you, Mr. Chairman.

Admiral, as the senior military officer, is it your opinion, are we compromising our security commitments, having to choose between Europe and the Pacific because of 4 years of budgets that have actually indicated a real decline in defense spending? Are we meeting our commitments, or are we not?

Admiral CROWE. First of all, Senator, I think it is important to understand that the budget we are talking about is not going to impact our current security. we are really talking about primarily modernization, updating and procurement about 3 or 4 years down the road.

We have a great deal of equipment that is still going to come into the order of battle that has already been paid for and is in the pipeline, but has not joined the forces.

So one of the problems in trying to determine the level of risk, whether it goes up and down or not, are you not really talking about today. You are talking about a point out in the future when the current investment comes to a stop.

Senator SYMMS. Okay. Thank you very mcuh. Now, the next question is, in your opinion, should we take the $200 million that is being spent on a Midgetman missile, that I think you have recommended that we don't build, and spend it on something else that we might need to use in the next conflict?

Admiral CROWE. In the current fiscal climate, yes, that is my opinion.

Senator SYMMS. That is your opinion.

Admiral CROWE. Yes, sir.

Senator SYMMS. I thank you very much.

Question number three. I was out in Idaho when there was an incident reported on the news, and it was in relationship of two U.S. Navy ships in the Black Sea. There were allegations that the Soviets were provocative. There were allegations that the U.S. was provocative. Who was being provocative, us or them, in that case?

Secretary CARLUCCI. Them, Senator Symms.

Senator SYMMS. They were being provocative?

Secretary CARLUCCI. We have had under way for some time a freedom of navigation program—indeed, it was started in the Carter administration—where we discuss with other countries the freedom of navigation rights that we all enjoy, and where periodically we test those rights. And we test them with regard to all countries that are infringing on freedom of navigation rights.

One of those rights is the right of innocent passage. And our ships in the Black Sea were exercising the right of innocent passage. They were passing through. They had done that before, some 2 years ago. And in using force against those ships, the Soviets were violating the freedom of navigation rights.

Senator SYMMS. What would our response have been if the Soviet captain, by design or by accident, would have accidentally, in his effort to brush our ship, would have really caused serious damage and possibly caused his ship or our ship to sink? What kind of capability would we have to respond to that?

Secretary CARLUCCI. Well, that is a hypothetical question and it would depend on the circumstances. As you know, we have had very serious incidents with the Soviets. They killed Major Nicholson, who was preforming legitimate functions in the military liaison mission in East Germany. We have protested that vigorously. We have yet to receive an apology.

Obviously, we would react in some way. If you are suggesting we would start a war on the spot, that is pure conjecture at this point.

Admiral CROWE. Senator, can I just say our ships operate all over the world with rules of engagement that permit them to defend themselves at any time. If he is really in jeopardy, he will defend himself.

Senator SYMMS. Thank you very much.

I had the opportunity to have breakfast this morning with General Gray, and the subject came up that they are actually going to cut three infantry battalions out of the Marine Corps strength, and that they are actually short, I think he said, two CH-53 from what they fell they need for their force projection.

Hearing Senator Nickles' questions, those of us who are not that close to military always think, well, why can't we cut out some of the headquarters troops, or reduce the size of the Pentagon, and keep the muscle in the infantry regiments.

What is the answer to that?

Secretary CARLUCCI. The answser to that is that we have those kinds of review underway. In fact, we have a very vigorous review of that underway right now. Admiral Crowe and I met on it yesterday, and we are looking at the size of staffs.

But nonetheless, we are not going to save the amount of money in reducing staffs to enable us to keep the kind of force structure that we had. We are going to have to reduce force structure somewhere.

Senator SYMMS. Just one final closing comment, Mr. Secretary. I hope you and the Admiral—and I don't know whether there is time to comment on it, but you may if there is time—will concentrate on Army procurement of light infantry weapons for our GIs in the Army.

It is my short experience on the Armed Services Committee that the Marine Corps is much better armed than the Army is right now, in terms of machine guns, rifles, and bunker busters, and other equipment. And I would hope someone will put some emphasis on buying some weapons for the Army.

Secretary CARLUCCI. I would be glad to look into that.

Senator SYMMS. Because I don't think that is a matter of money. That is a matter of priorities and planning and making a decision on purchase.

Thank you very much. I appreciate you both being here.

Chairman CHILES. I think that right now, I will run and vote; we will have some people coming back, and we will try and get the hearing started again as soon as we can.

[Short recess.]

Senator SASSER [presiding]. The committee will come to order.

We are following the early bird rule here this morning, and that means Senator Symms concluded his questioning, so we move to Senator Conrad.

Senator CONRAD. Thank you, Mr. Chairman.

Mr. Secretary and Admiral Crowe, you will forgive me if I express a somewhat different perspective this morning. It strikes me as a participant of the Budget Committee that in all of the budgetary matters, we continue to be divorced from the fiscal reality that we confront. Somehow we have drifted from being able to deal directly with the very hard choices that must be made.

You all know the litany—we have tripled the debt; increased the trade deficit sixfold; we have become a debtor nation for the first time since 1914. Those things fundamentally alter the types of decisions that we can make.

And at this very time, our allies are in a position of not sharing on a proportionate basis of the common burden. That is, we spend about 6 percent of GNP on defense; other NATO nations are somewhere around 3 percent—slightly over that. And our friends in Japan are at 1 percent.

More and more people are questioning the logic of paying for the defense of Japan and Western Europe and borrowing the money from them to do it.

As you perhaps know, last year Senator Sasser and I authored an amendment to call on the President to negotiate with our allies during this year to achieve a more equitable distribution of the defense burden. At the end of the year he is to report back to Congress. We delivered a letter to him before his trip to Brussels, asking him to start that process.

My question is what role can you play in that process, and are you willing to play a role in that process?

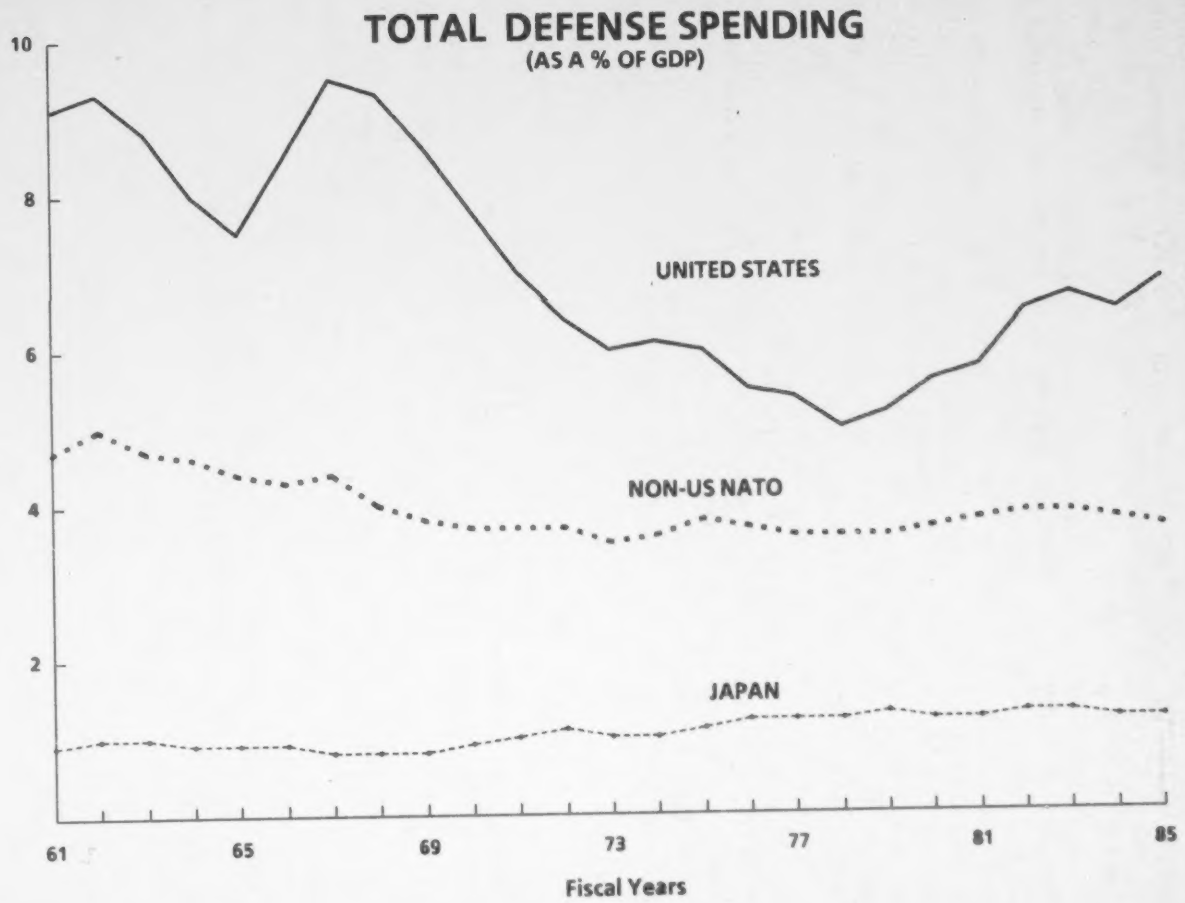
Secretary Carlucci. Well, Senator Conrad, I am playing a role in that process. At my first meeting with the DPC in Brussels, I raised this issue; I do raise it with my colleagues. In bilateral meetings, we have had intensive discussions with the Japanese on this. So we are actively engaged.

I would caution that in this kind of an area, you make progress at the margin. It is not a panacea for our defense budget problems.

I would also argue with you very strenuously—I think you were quoting others as sayinig this—that we are not really paying for the defense of Japan and Western Europe. The heart of our strategy is a coalition strategy, and it is laid out very clearly in the President's report to Congress on national security strategy.

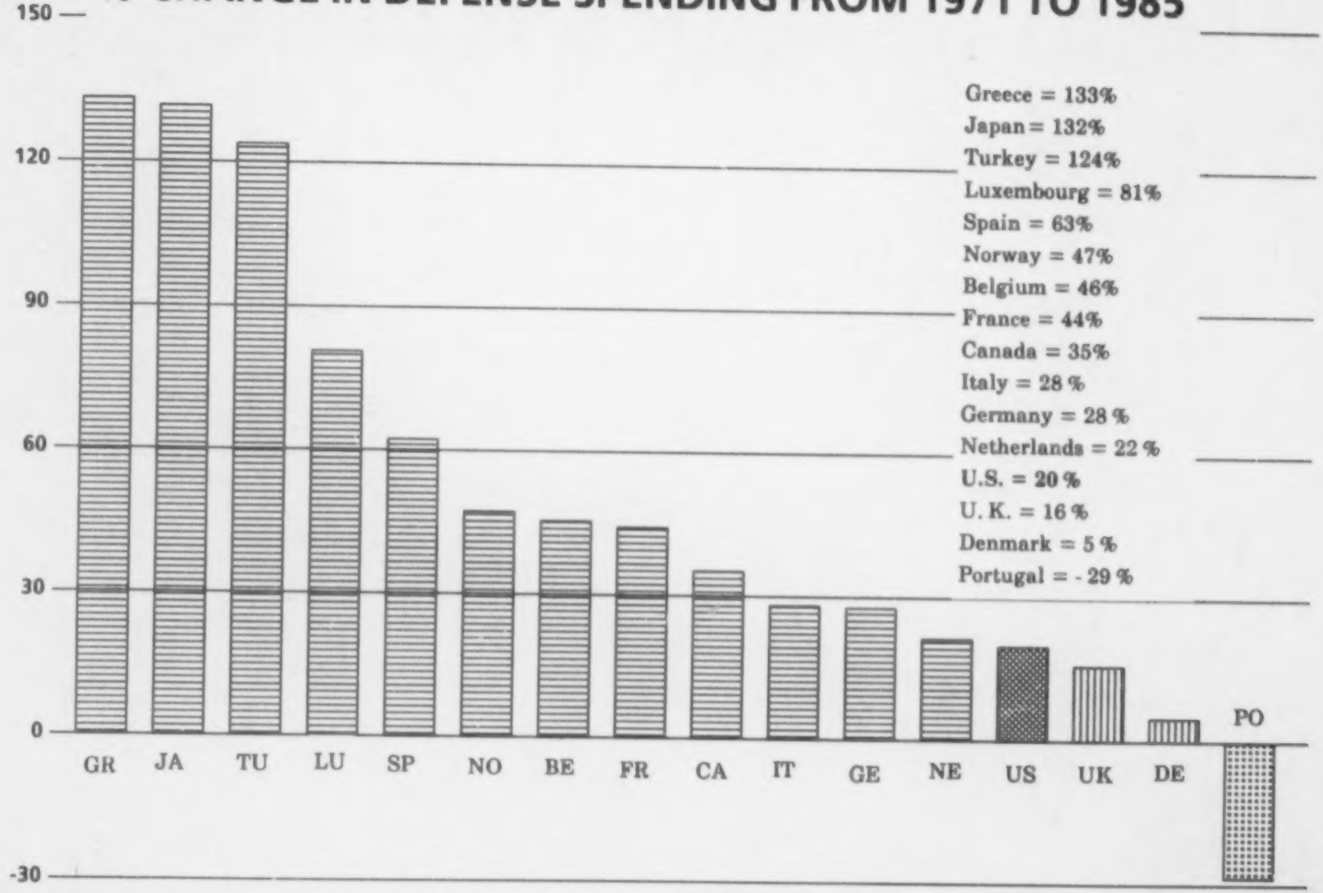
We are there because it is in our best interest, and actually, in terms of their overall defense budgets, the allies' defense budgets have gone up at rates that generally exceed ours. I have a few charts on that.

Here is a chart on defense spending, showing that non-U.S. NATO remains more or less constant; Japan goes up; ours goes up and down.



TOTAL DEFENSE SPENDING
(AS A % OF GDP)

% CHANGE IN DEFENSE SPENDING FROM 1971 TO 1985



Secretary **Carlucci**. There is a bar chart, where you can see percent change in total defense spending on the United States is way down at the lower end of the scale. Now, once again, in terms of GNP, this budget would consume about 5.7 percent of our GNP. It has been going down steadily.

In terms of GNP, yes, we spend more than our allies, but it is true that we have worldwide responsibilities that they do not always have. They are contributing principally to Europe.

With the Japanese, I think we have made good progress. In fact, there are voices that sound alarms that Japan will now have in a couple of years the third largest defense budget in the world. We don't think there is cause for alarm, but we have had good success in getting the Japanese to contribute.

But the direct answer to your question is yes, we will continue to work this problem. I would only urge that we work it as a national security problem and not as a budget problem.

Senator **Conrad**. Mr. Secretary, let me just say that the reaction that I find in the general public is that we are getting snookered; that our friends in Japan say, "Look, we are increasing our spending at 5 percent in real terms," and just like the chart you showed, growth rates are different, but we are off a totally different base. They are at 1 percent; we are at 6 percent. Their 5 percent increase is on a 1 percent base, and it is going to take them an awfully long time to come anywhere close to the kind of defense burden that we bear. In the meantime, they take the difference, invest it in education of their children. They invest it in consumer products and kill us in the international market place. The money that we spend on their defense is borrowed from them. That is what I think troubles people.

They feel that we are getting taken. We talk about our worldwide obligations. I think we do have worldwide obligations. I think they also have worldwide obligations, and the problem is, we are taking so much more of it on our shoulders than they are on theirs.

Secretary **Carlucci**. We are taking more of the worldwide obligations on our shoulders, but I think time and again it has been demonstrated that the forward deployment of forces is in our best interest. A military relationship with Japan is clearly in our best interest. And within the roles and missions that we have defined for Japan—that is to say the defense of the homelands and the sea lanes out to 1,000 miles—I would be hard-pressed to tell them how they could spend 3 percent of their GNP effectively. They may, over a period of time, be able to grow to that level, but you do not want to have pure, runaway growth in the defense budget.

So I think the steady progress that they are making in building their defense forces is welcome. They need to continue that progress, and they need to be encouraged for what they have done and need to be told that they need to do even more. And that is exactly what we are telling them.

Senator **Conrad**. Thank you.

Senator **Sasser**. Thank you, Mr. Secretary.

Thank you, Senator Conrad.

Senator Johnston.

Senator **Johnston**. Thank you, Mr. Chairman.

Mr. Secretary, first let me echo and associate myself with what Senator Exon said, in complimentary terms, about you and your new administration in the Department of Defense; I very much agree with that.

Now, second, I am a strong supporter of the rail mobile deployment and believe therefore that Midgetman would be a huge mistake, and I applaud your desire to make a choice and understand why you cannot make a final choice and am inclined to agree with that, considering that this is the twilight of this administration.

There is another question, however, that I want to make clear, and that is that while you have endorsed the concept of an additional 50 or a total of 100 warheads on rail mobile MX, this budget as I understand it does not make any definitive steps in that direction. In other words, this budget is consistent with the deployment of the existing 50 warheads and rail mobile; is that correct?

Secretary CARLUCCI. That is correct. This budget seeks an additional 12 missiles which would go into the overall pool. It also seeks $800 million for continued development of the rail mobile, and as soon as we have reached the appropriate stage, we would come to the Congress and say we now want to endorse this system, and we want to start to deploy some of the missiles that are in the pool and those that are in the silos and whatever new missiles you will vote us on the rail mobile mode.

Senator JOHNSTON. Now, if the Congress, for whatever reason, should not authorize the second 50 MXK, would you nevertheless feel that rail mobile deployment of the first 50 is an appropriate thing to do?

Secretary CARLUCCI. I would, sir.

Senator JOHNSTON. So that those of us who strongly believe in rail mobile ought to be for the money you have here—which is all R&D money, is that correct——

Secretary CARLUCCI. It is all R&D money, yes.

Senator JOHNSTON. And how much is it?

Secretary CARLUCCI. it is a little short of $800 million; it is $779 million, or something like that.

Senator JOHNSTON. And by the way, what does that accomplish in terms of R&D? How far away from an IOC is that?

Secretary CARLUCCI. I think we were thinking in terms of late 1991 IOC.

Senator JOHNSTON. All right. Well, I hope you will continue to point out that distinction that we need this $800-odd million for R&D for rail mobile; that we need that even if we are only going to put the first 50 in and not authorize the second 50——

Secretary CARLUCCI. That's correct.

Senator JOHNSTON [continuing]. Because I know that there are groups out there that are opposing the second 50 and may oppose putting the first 50 in rail mobile simply because they see that as a way to stop the second 50.

Secretary CARLUCCI. No. If I may underscore the point, we need the R&D for rail mobile, even if we deploy the first 50, and we also need the 12 missiles because, as you are well aware, we do need missiles for testing, aging and surveillance. We can use those missiles any way you go.

So right now, we are in a flexible mode, but I am firmly convinced that rail mobile is the way to go, and at a very minimum we ought to take the 50 out of silos and hopefully we can get 100 rail mobile.

After all, the Soviets are going to have substantially more than that. They have both a rail mobile and a road mobile system deployed right now.

Senator JOHNSTON. But we will face that question of the second 50 in another administration. But it seems to me we ought to get rail mobile going right now.

Now, one of the criticisms of rail mobile is that as you reach a crisis situation—we both agree that a bolt out of the blue is not a plausible threat, that the threat would come as a buildup, either suddenly or slowly—and one of the criticisms is that in order to protect rail mobile, you would have to move them out of garrison, that that would be provocative or an escalation in itself.

Now, you do have plans, do you not, to move rail mobile up and down the tracks periodically, so as not to have the provocation that might come in a crisis; isn't that correct?

Secretary CARLUCCI. Yes, they would move up and down periodically. They look like normal railcars. We don't need to announce to the world that we are deploying. Of course, it depends on the outcome of a START agreement, whatever CBMs you might have built into that. But it would not be provocative.

Furthermore, I have been in situations where we have wanted to send signals by increasing the alertness of our force. In many cases, that is a desirable thing to do. It should not be interpreted as an undesirable thing.

Senator JOHNSTON. A final question. You have no funds for testing which violates the strict interpretation of the ABM Treaty, as I understand it, in this budget.

Secretary CARLUCCI. That's correct.

Senator JOHNSTON. Now, we have heard in prior years that picking the 10 top technologies that relate to SDI—computer capability, rocket, et cetera—that, if I recall the figures, the United States was ahead on 7, we were tied on 2, and maybe the Soviet Union was ahead on 1—that order of magnitude.

Does it continue to be true that we are ahead in most SDI technologies of the Soviet Union?

Secretary CARLUCCI. I am not familiar with the comparison you are referring to, Senator. I think that is a little bit difficult to judge because they have different configuration for their system. Theirs is a ground-based system. There is certain laser technology where they are ahead of us; we are ahead of them in the free electron laser area.

So there are some technologies where they are ahead of us; there are some technologies where we are ahead of them.

Our technology lead, though, is much more suited for the kind of space-based system that we are talking about; whereas their technology is much more suited for a ground-based system.

The key to SDI, as I understand—and I am no engineer—is to really get the sensors and to get battle management. And that is an area where, with data processing and rapid communication, we have a lead.

So I think the configuration of our SDI program tends to fit with our own technology advances.

Senator **Johnston**. Thank you very much, Mr. Secretary.

Senator **Sasser**. Senator Danforth—I want to apologize to Senator Danforth. I did not see you underneath those intense television lights a moment ago.

Senator **Danforth**. Mr. Chairman, thank you very much.

Mr. Secretary and Admiral, I would like to ask your views on the security implications, the defense planning and budget implications of events in Central America, if they have any implications.

It would seem to me that if the United States has security interests anywhere in the world, it has security interests in our own hemisphere; that the position of the administration, with which I agree, is that the government of Nicaragua is a Communist government, validly so, it is engaging in a military build-up; it has articulated a policy of fomenting revolution beyond its own borders; it is surrounded by countries that are politically, economically and militarily weak.

I would think that a much more plausible threat to the interest of the United States than, say, a nuclear attack by the Soviet Union would be mounting chaos in our own hemisphere with the possibility of terrorist activity on our border.

Then, that situation is complicated by recent conditions in Panama, and I suppose elsewhere, where drug dealers are in control of the military in their country and are in the business of exporting drugs to the United States.

Historically, I would suggest that had that happened in America's past, we just would not have tolerated it. We would have done something about it. Now, we are talking about economic sanctions, freezing bank accounts, and whatnot.

What I would like to know is from all standpoints, what are the implications for defense planning and for defense spending down the road of the events that are now taking place in our own hemisphere?

Secretary **Carlucci**. I think these events have very serious national security repercussions, and I am sure Admiral Crowe would agree.

A while back, I sent a letter to all Members of Congress, outlining our security concerns. Sixty percent of the shipping to NATO in the event of a war would go out through the gulf; and the importance of the Panama Canal self-evident.

If you take the revelations of Colonel Miranda—and we have no reason to doubt them—we are talking about a 600,000-man Nicaraguan army with eventually some sophisticated aircraft in Nicaragua, a capability to conduct surveillance operations up along our entire west coast, a capability to undermine the nascent democracies in Central America—and it would certainly take a lot of resources to strengthen those democracies.

I think the decision of the Congress—the House—not to continue support of the contras is very unfortunate because it could mean eventually the kind of action that you are suggesting, and I do not think that is a desirable way to solve those problems.

Senator **Danforth**. Well, I agree with that, but the decision has been made. The Speaker of the House of Representatives has wrested control of our Central American policy to himself, and the question is what are the implications with respect to the Department of Defense, military preparedness; is there a concern for the first time in 100 years about our southern frontier——

Secretary CARLUCCI. On, there is indeed.

Senator DANFORTH [continuing]. And how, if at all, should that be reflected in our consideration of the defense budget.

Secretary CARLUCCI. Over a period of time we are going to have to put more resources in that area and given the budget constraints, are going to have to take them away from some other area. But let me ask Admiral Crowe to comment specifically on the military aspects of this.

Admiral CROWE. Well, I would reflect what the Secretary has said, Senator, primarily with respect to the Panama Canal and the flank of our major lines of communication out of the Caribbean, and of course, the progress that we have made in promoting democracy in Nicaragua's neighbors, which is rather fragile, and I see that in jeopardy the way events are going.

As far as our military capability, our primary security pillar in that part of the world has been security assistance. And I see security assistance disappearing as a foreign policy tool, and that is handicapping us in our ability to strengthen our friends and allies in that part of the world and to promote stability in ways that I think are acceptable to our country, and I consider that a very dire development.

As far as our ability to handle problems militarily, if a decision was made to deploy to that part of the world, we can do that. This budget will permit that.

Secretary CARLUCCI. Yes. I mean, if you are talking about a crisis, we would have to take a carrier battle group from somewhere else and put it in the Caribbean. And judging from history, the Soviets have a tendency to hit you somewhere else, to create a crisis somewhere else, and then you withdraw a battle group or any kind of military forces from that particular area. So in a sense, it is a zero sum game.

Senator DANFORTH. Well, it is easier, Mr. Secretary, to deal with a true military crisis than to deal with ongoing chaos, isn't it?

Secretary CARLUCCI. Yes, it is, although we are moving in the direction, as you are well aware, of strengthening our capability to deal with low-intensity conflict.

But let me underscore what Admiral Crowe said on security assistance. We have El Salvador, which has been virtually a model of transition to democracy, where we have skimped on security assistance. Our Ambassador to El Salvador was in to visit me yesterday, and he said, you know, for $15 million more, we could help El Salvador put down the insurgency, instead of just keeping it at the level which it is.

Now, that is penny-wise and pound-foolish, if you look at the military capability that it would take to deal with an entirely Communized Central America. And that in my judgment is a distinct danger.

Senator SASSER. We have let you run over your time, Senator Danforth, by about 4 or 5 minutes, so I am going to have to call it to a halt and exercise my prerogative as chairman to be the next questioner.

Senator **Danforth**. Thank you, Mr. Chairman.

Senator **Sasser**. Mr. Secretary, we are doing this democratically—and I got here before you did, Senator Sanford.

Mr. Secretary, I want to take this opportunity to commend you for the job you are doing and to commend the Chairman of the Joint Chiefs of Staff. I think what we are seeing now is a Secretary of Defense and a Chairman of the Joint Chiefs who are making the tough, hard choices in the Department of Defense and assigning priorities to what must be done there.

I fear that has not been done in recent times. As a result, I see us moving back now into the old spending category or pattern of mountains and valleys in our defense spending, and I think that is unfortunate.

I have always thought that the proper approach was taken back in 1978 or 1979 by a previous Secretary of Defense when he indicated we ought to increase defense spending by 3 percent a year in real terms and do that in concert with our allies in Western Europe.

But I am encouraged with the steps that you have been taking in recent weeks. I want to also commend you on your realization that we do have a problem with sharing the common defense of the free world with our Western European allies. I think for the first time we are getting some real concern coming out of DOD on the question of burdensharing and also some concrete steps to try to convince our allies that they must take a greater role.

I am particularly pleased with the approach you have taken on the issues of the 401st Tactical Fighter Wing in Spain. That is the wing of F-16 fighters there. Last year I included amendments in the military construction bill which the Congress adopted, which required that no U.S. taxpayers' money be used to relocate that squadron to another NATO base in Western Europe; that if that wing was to be moved—and I think the initial cost of moving it is $500 million, or up to $500 million——

Secretary **Carlucci**. Up to; I think it may be a little less.

Senator Sasser [continuing]. That that would be borne jointly by NATO, just as we have shared expenses with NATO allies on various military construction projects in Western Europe in other times.

What progress are we making, Mr. Secretary, with our NATO allies with regard to that F-16 wing and getting them to help pay the expense of moving it, if we do move it?

Secretary **Carlucci**. Mr. Chairman, there has been considerable discussion of this in Brussels; I think there is a general consensus that this is a NATO problem. I myself have met with the Italian Defense Minister, Minister Zinone, who was extremely cooperative on this score. He and I held a joint press conference in which we both said that we thought it was essential to retain this capability in Southern Europe, but this was a NATO issue, and we were going to work within NATO to accomplish it.

Minister Zinone indicated that the Italians were waiting for some sign from NATO in general that infrastructure money would be provided, and then they would go ahead with the base surveys.

There is a little "chicken and egg" here because our NATO allies are saying, well, until they have the base survey, they don't know how much money needs to be spent, but I am sure that is a problem we can work out.

The Italian Government has not made a formal decision. All they have said is we think it is important to keep the capability in Southern Europe, and they are willing to work within NATO to see if there are ways to maintain that capability.

As you are well aware, the Italian Government has fallen and have a lame duck government in place, so it is a little hard for them to make decisions.

The bottom line is, I think we can get most of the funding out of NATO infrastructure. There may be some things that are peculiarly American that would not be eligible for NATO infrastructure funding. I would envisage that those amounts would be relatively small, and there are ways that I think we can solve that problem. But I think our NATO allies recognize now that this is a NATO issue.

Senator **Sasser**. The question of burdensharing has becoming, I think, uppermost in the minds of a lot of Senators and Congressmen these days, and also uppermost in the minds of a lot of citizens. I have been concerned about it for some years. And one thing that comes to mind, however, as we move in the direction of trying to get our NATO allies to contribute a larger share to the defense of the free world—there is a criticism of Japan's role, and there is pressure to try to force the Japanese to increase their defense spending. That is very unpopular with the people of Japan, based on my conversations with them there. They have had their bout with militarism in the thrities and forties, and those who remember it don't like it, and the Japanese man or woman on the street is not interested in increased defense spending.

To some extent, I sympathize with them, because I am old enough, and you are, too, to remember when the Japanese were a paramount or a great military power in that region of the world, and many other countries in Asia remember, and they have very bad memories of the greater Far Eastern or Eastern Asian co-prosperity sphere. And when the Japanese start rearming, if they do, this could have a very provocative impact on China, Korea, other countries, the Philippines, and other countries in that region of the world.

So, given the fact that the Japanese people don't want to re-arm, given the fact that they now have the second most powerful economy in the world, given the fact that they must make a substantial contribution to the defense of the so-called free world, I am searching for other ways that they can do that rather than procuring military hardware and building a force structure to operate that.

Secretary **Carlucci**. So are we, Senator.

Senator **Sasser**. Well, what suggestions do we have along that line?

Secretary **Carlucci**. First of all, let me say that we think we have made steady progress, as I have indicated earlier, in getting Japan to increase its military budget. Second, they are doing more than any other country in terms of host nation support—$2.5 billion, $45,000 per serviceman; they have just agreed to pick up 100 percent of our labor cost.

And we have defined the roles and missions in such a way that they need not be a threat to other countries in the region as they increase their defense budget, because their role is defense of the homelands and the sea lanes out to 1,000 miles.

The Japanese are moving up the scale in terms of foreign aid. They are among the top three or four foreign aid donors, if my memory serves me correctly, right now. In many instances, their aid has been tied aid, and we are trying to get them to move away from that. But they are beginning to target their aid in areas such as Africa and South America, where they can pick up some of the slack as we cut back on our own foreign aid.

An area of particular interest to us, of course, is the Philippines where the Japanese have made some loans. We are encouraging them to do more.

Senator **Sasser**. If I could just interrupt you there, Mr. Secretary. The base rights in the Philippines are going to be up for renegotiations in the not too distant future; both Subic and I think Clark may be more or less simultaneously considered.

Secretary **Carlucci**. That is correct.

Senator **Sasser**. Now, we are presently, if memory serves me correctly, paying somewhere in the neighborhood of $120 million a year now for those leases, and some members of the Philippine legislature are talking in terms of $1.2 billion for new leases for those bases. I think that is probably an exorbitant figure. But it occurs to me that that is one area where the Japanese could be very helpful. In other words, they could help pay the cost of these leases, or defray them, and I have recommended that we seek to establish a new multinational financial arrangement with regard to leasing these military bases that would be patterned after our NATO infrastructure program where everybody pays a certain amount.

What is your reaction to that? Perhaps Admiral Crowe might want to react, also.

Secretary **Carlucci**. It is an interesting idea. I think the Japanese would tell you, and maybe our own lawyers would tell you as well, that they have constitutional problems with anything that smacks of out-of-area activity in the military sphere. Indeed, that's what they told me when I talked to them a bit about the Philippines. Money is fungible, obviously, and economic assistance can be useful; maybe some economic assistance can supplant some of our security assistance. But there ought to be ways that we could work flexibly with the Japanese on this. Secretary Shultz and I have personally discussed this. The State Department is actively looking at it in conjunction with some of our people.

So you and I are thinking along very much the same lines. We have to be creative here, without raising the specter in Southeast Asia of renewed Japanese military activity out-of-area. But I think this can be done.

Admiral **Crowe**. I welcome any imagination that we can bring to bear on the problem, Senator. Of course, in my parochial perspective, it is important that we renegotiate Clark and Subic in a successful fashion, and any way we can generate help would be applauded.

Senator SASSER. Thank you, gentlemen.

Chairman CHILES. Senator Grassley.

Senator GRASSLEY. Mr. Chairman, I have some questions on the 5-year defense plan that I want to ask the Secretary, but I would also ask the committee members to consider that I am directing my remarks toward the entire committee as well as to the Secretary of Defense before I ask my questions, because I think these are things that we have got to consider as we consider this budget coming up.

I think it is fair to say, Mr. Secretary, that this administration is going to leave this country and the next President with a monumental defense burden. Much of it was caused, in my view, by profligate defense budget spending. Richard Delower once described the defense increases of the eighties—Mr. Chairman, you remember me talking about this 4 or 5 years ago as Richard Delower expressed it this way—"opening the money bags at both ends".

Paradoxically, we have managed to spend ourselves silly on defense and at the same time, we have reduced force structure, reduced modernization rates vis-a-vis the last administration, and just barely hold readiness constant.

The problem has not been for the lack of money, obviously. In 1985, we surpassed the peak year of the Vietnam war in spending, and that was in constant dollars, and we are currently just a little bit below that level.

Rather, the problem is due, I believe, not because we did not appropriate enough money, but to poor planning, which has caused cost overruns and which in turn have caused wholesale reductions in force structure. And the significant reduction in this force structure in this budget that is before us now, I think, is only the tip of the iceberg.

In 1983, this committee—and Mr. Chairman, you will remember that it involved members on both sides of the aisle—warned that this was going to happen unless we stopped underestimating the 5-year defense budget. It was clear even way back then that we were starting too many programs and underestimating their costs.

When the actual bills came in, we had to shrink quantities to live within the available resources, and of course, that caused costs to go up, and that produced inefficiencies in our defense factories. And of course, then we were told that these were historical problems, but that things would be different from then on.

Now it is 5 years later since this committee discussed some of these things, and the record shows that underestimating of the defense budget, like history, repeats itself.

We have continued to get shrinking forces at higher prices.

Now, the problem I am describing is a familiar one to all my colleagues, and Mr. Secretary, it is not a problem just with DOD. Congress in this area of underestimating costs, overestimating income, has sins in this area as well, because what I have described here for DOD would be analogous to this Budget Committee assuming real economic growth which might average at an unrealistic 8 percent over the next 5 years and then planning a national budget that way, and then thinking in the process of doing that that we were rolling in dough, and that we not only under those circumstances failed to cut spending, but we actually would increase spending and initiate all kinds of new programs.

But then, when we finally woke up to the facts of life in this committee or this Congress, that we were only going to have GNP growth at 4 percent instead of 8 percent, then we start cutting programs left and right, or else allow the deficit to swell.

Now, in defense, instead of a swelling deficit, since we fund it with the top line budget level, your forces are shrinking, and your costs continue to overrun. That is what we have had for the last 5 years, even though this administration would say that it never happened.

Now, newspapers across this country are now writing about this problem, and they use headlines like this: "Future Shock for Defense" or "Horrific Scenario". Some of them have referred to it as "a defense meltdown" or "How's the guillotine going to fall this time?"

Now, I know, Mr. Secretary, that you did not preside over this problem, and Congress contributed to this problem to a considerable extent. But you did inherit it. And some of us are still going to be around for a few years just to fill out our term, if nothing else. And beyond, we are going to have to deal with this problem.

In the meantime, as Secretary of Defense, you have an opportunity to help correct the underestimation problem before you leave office. And an amendment passed on last year's DOD authorization bill requires that DOD submit annually to Congress, by April 1, the 5-year defense program used in formulating the budget request.

I hope you intend to comply with this amendment, as I and my colleagues believe that this is a crucial part of correcting some of the problems that I have mentioned here.

In that regard, I'd like to ask did the Department of Defense produce a new 5-year budget plan this past winter, and is that 5-year plan the basis for formulating the fiscal year 1989 budget request?

Secretary CARLUCCI. Senator Grassley, before I answer your question, let me make a general comment.

I have lowered the top line estimates in the outyears from 5 percent to 2 percent. We have made substantial cuts in programs in weapons systems.

But I disagree very strongly with the thesis that we are no better off than we were in 1980. If I take you back to 1980, I can remember looking at mission-capable rates of 55–58 percent for our planes. Our Navy was at an all-time low in numbers of ships. Just look at some of the weapons systems that have come on line—the Bradley Fighting Vehicle, the M–1, the 688 class, the Trident, the Apache. Sustainability is up.

The quality of our people—recruitment and retention—is a star performance. In 1980, in the SAR reports, there was a 14 percent average cost increase. In 1986, it was less than 1 percent.

In this budget, we have tried to control cost escalation by sacrificing force structure, cutting out weapons systems, in order to produce the others at efficient rates. We have come up, time and again, and asked for multiyear procurement programs. We asked for six last year, and we got four.

So we are making every effort.

In terms of the 5-year defense program, it was totally impossible for us in the 5-week period since the Congress changed the top line to redo the entire FYDP. Now, to comply with the law, we will send up the old FYDP, but it is totally unrealistic. It is based on 3, and in some cases, 5 percent top line estimates in the outyears. You cannot turn a $300 billion budget around totally in a 5-week period.

We will comply with the law. Having said that, I have to tell you that, in my honest judgment, the law is ill-advised. I won't have to be around to face the consequences, but what you are doing is taking a very valuable internal management tool and making it into a public document. And the services, when they come in with their POMs, when they construct the FYDP, will have that very much in mind, and I don't think we will get the kind of accurate estimates that you think we will get out of the FYDP.

But as I say, that is somebody else's responsibility. We will produce a new FYDP in conjunction with the 1990 budget, and we will make it available to the Congress.

Senator **Grassley**. Mr. Chairman, I will submit the rest of my questions for response for the record.[1]

Chairman **Chiles**. Thank you.

Senator **Grassley**. Let me have one reaction to what the Secretary said, because he is a new person, and I think he is sincere in his approach to this, and he is making a lot of changes that should have been made a long time ago.

But I guess the bottom line or the point that I was trying to make in my long remarks was that we are not better off in terms of what we are getting for the money. That is my main point. We still have rising costs and shrinking forces vis-a-vis our plans that we had.

Secretary **Carlucci**. Vis-a-vis the plans, we are falling short. There is no question. We have had to take somewhere in the neighborhood of $500 billion of programs out of our plans. But if I may, Mr. Chairman, before you came in, Senator Grassley, I indicated that I think there are ways we can save money in the procurement accounts. And I would be glad to make a deal with the Congress. I whole-heartedly endorse coming up with a FYDP, particularly in the procurement area. In fact, I think that is the area we ought to concentrate on.

I will tell you, I will break out the procurement programs on a 5-year basis if you will vote 5-year money. Then I will sign up for 15, 20 percent savings in the procurement accounts, and I am perfectly happy to cost that out.

Chairman **Chiles**. Thank you.

Secretary Carlucci, to accommodate constrained defense budgets, the Defense Department is proposing a number of program deferrals that would save over $1 billion in 1989. Many of the programs deferred are going to have significant budget requirements in the future contributing to the so-called "bow wave" phenomenon.

How great are the savings likely to be in the outyears for these deferrals? In other words, wouldn't it be more efficient to cancel some of these programs outright and use the savings to sustain readiness improvements or to fund long-term research and development programs?

---

[1] See p. 160.

Secretary CARLUCCI. It may well be, Mr. Chairman. That is what we are going to determine in the 1990 budget cycle. These programs were deferred so that we could make a more considered judgment on them. In some cases, they had some problems associated with them.

Our savings do go up geometrically, of course, in the outyears, and that is one of the advantages of taking your cuts in force structure, because they give you higher savings in the outyears.

I can give you these two assurances, that when we come in with the 1990 budget, everything will fit under the top line, and everything will be fully funded in the outyears, and we will not attempt to create any bow wave; and second, if the programs do not fit, we will cancel them. But right now, we needed to preserve some of our options.

The second assurance I will give you is that the same priorities I listed here at the outset—readiness, sustainability, and buying at efficient rates—will continue to prevail as we go through the 1990 budget. But that may mean more pain, and I would simply enlist the support of the Congress for the approach I am taking.

Letters are already flowing in, and telephone calls flowing in, telling me I can't do this, I can't do that, my priorities are all wrong. I would seek your endorsement of these priorities and the recognition that this is going to hit every State and every congressional district.

Chairman CHILES. I want you to be sure and put my letter on top of Senator Domenici's; put it at the top of the pile.

Senator DOMENICI. On top, you said? Well, you are not going to be around too long.

Chairman CHILES. Well, that's why I need to get my letter in ahead of yours.

Senator DOMENICI. It seems to me you ought to be charitable to your friend of long standing, who might be around here for a while.

Chairman CHILES. I'll worry about that later.

Mr. Secretary, the recent establishment of the position of Under Secretary of Defense for Acquisition certainly represents a major development in the defense acquisition reform movement, and other actions, completed or in progress, like the creation of the Defense Enterprise Program and the streamlining of acquisition structures in each of the services, and the establishment of the Defense Resources Management Board.

Obviously, one of the ways we gain with our limited dollars is to enhance our business practices. What is the status of the major structural reforms in acquisition, and how do they appear to be working?

Secretary CARLUCCI. Well, if you are talking about the reorganization, it is in place. We have an Under Secretary for Acquisition. This came from the Packard Commission, on which I participated. I am a strong supporter of the Under Secretary for Acquisition. He has taken charge. He, with the co-chairmanship of the Vice Chairman of the Joint Chiefs of Staff, will be running the Defene Acquisition Board. That is working extremely well.

The streamlining program is going forward. We have instructions out, consistent with congressional legislation, that we will not use firm, fixed-price contracts in the R&D area, and I thoroughly agree with that.

We have given authority to contracting officers to review the number of people who come onto plant floors, which I think has been a big problem. And we are moving, as I indicated earlier——

Chairman CHILES. How is the streamlining process being accepted by the branches?

Secretary CARLUCCI. Oh, I think it is being well-received. I think everybody is in agreement that we have made the rules and regulations far too complex. So I think the services are receiving it in a positive vein, as is industry.

I would now like to move on and emphasize quality, to change the entire environment in which we purchase to be much more results-oriented as opposed to process-oriented, and to stop second-guessing contractors every step of the way and to hold them accountable fully for the results. It doesn't mean we weaken our inspection or auditing system, but it does mean that we look at the whole process from start to finish much, as I said earlier, like the Japanese have done.

Chairman CHILES. We understand that we may have some major problems in the readiness and military personnel accounts that could require additional flexibility in your reprogramming authority for 1988.

In order to do that, I think we are going to need detail justification data as soon as possible so that we can work with you in this program. I think you well understand part of that reprogramming, depending on whether we are coming from slow spend-out to fast spend-out, all of those kinds of things, we are going to be required to score in regard to how we are staying with our caps. So the sooner we get that kind of information from you——

Secretary CARLUCCI. May I comment on that, Mr. Chairman?

Chairman CHILES. Yes.

Secretary CARLUCCI. I admit that is a problem, because the only way I can see to solve these facts of life costs is to increase our transfer authority. If we do not, the kinds of layoffs that were referred to earlier will be dwarfed by what we are going to have to do toward the end of the year. We will be having mass layoffs toward the end of September unless we solve this problem early on.

We will be moving money from the slower-spending procurement accounts into the fast-expending O&M accounts. What we need at the outset is the overall transfer authority, based on the assurance that we will manage outlays. And while our track record in managing outlays is very good, I must say I don't much like being controlled by both outlays and budget authority. I think that distorts your procurement program, and it distorts all your programs. But since that is the real world, we will manage outlays to the figures.

We will have to come up with individual programming requests as we move funds from one account into the other, so I prefer not to have to identify all the offsets in advance of getting the transfer authority. If you can give me the transfer authority on the assurance that we will manage outlays, we will then come up on a case-by-case basis.

Chairman CHILES. Well, I think we are going to need the justification data.

Secretary CARLUCCI. We will give you the justification data, yes, sir.

Chairman CHILES. Senator Domenici.

Senator DOMENICI. Thank you, Mr. Chairman.

I might say to you, Senator Kasten, that I have not had any questions yet, or else I would yield to you.

Mr. Secretary, let me again join with those who have commended you and the Chairman of the Joint Chiefs for the efforts you have this year to live within these fixed targets.

I wish Senator Grassley were still here, because I have the greatest respect for him, and I think clearly, during those years with very high inflation, unpredictable energy prices and unpredictable costs of procurement, I believe we did ourselves into some real muddles in terms of what was sitting around, really unallocated, not even needed. And I think the impression came that the Defense Department didn't quite know what they were doing, or were holding back $6 or $8 billion so they could spend it someplace else.

But frankly, I think that whole problem is just minuscule compared to how in the world we could run a Defense Department with the kind of enormous ups and downs you have experienced in your budget. And frankly, if our purpose is to be part of a free world protection against the Soviets, we must do much better. They do a lot of things wrong, and I am not an advocate of anything they do, but clearly, they do not do stupid things like starting procurement uphill at 9 percent and then expect it to drop 9 percent in the other direction, midstream, with thousands of contracts out there. I think that is the biggest issue in procurement, and if I might say, I think the Administration may have been overly committing more than we really could accomplish in the inventory of weapons that we kicked off early in this buildup.

Having said that, I urge that both of you take advantage of an environment. I think defense in a democracy responds to the perceived concerns of the Congress as these are first perceived by the people. And frankly, I think with the cuts that we are taking now, the environment is right to do something truly constructive in the areas of procurement. For that $80 billion in defense procurement, I urge that we really start a collaborative effort to show Congress and the American people how absolutely erroneous it is to treat this on a yearly basis, rather than on a three, four or five year basis. But I believe two things have to evolve, Mr. Secretary.

I think you have to honestly show the horror stories that result from the way we are doing it—even if it means admitting that we are paying more than we should, that we are getting less than the best. I think in the environment where the Members are feeling things cut in their districts, they might be looking for a way to better the situation.

I personally think that we might be able to do a true, multiyear procurement budget, and we might be able to get some help on every front. Maybe even the appropriators would join in trying to isolate that account and let it run, if you all can give some ideas on how the commitment will run in the other direction on savings and quality.

I believe it is an exciting challenge. I have never seen as many people interested in it up here as I do this year. Instead of browbeating, they are trying to ask: How can we do better. And I personally don't see how the Department manages its contracts under the circumstances we impose upon it every year.

We have a huge procurement office in Albuquerque that procures for the Air Force all over the country. There are not very many people there, but they manage billions of dollars annually. I really don't understand, when we appropriate late, when you don't know what the budget is going to be, when you have that game plan that has been changed four times in a period of 18 months—the five-year plan, the three-year plan—I don't know how they manage as well as they are doing.

So I really urge that we be constructive, and I think it might work.

Secretary CARLUCCI. I think that is a fine suggestion, Senator Domenici, and I would be delighted to work with you on this.

As you point out, it is worse than just a yearly basis on that chart, because we don't get the budget usually until 4 or 5 months into the year, and there are horror stories. The biggest horror story, though, is that our defense industry is not reinvesting its profits, and that tells you something. And indeed, some of the companies are now saying they are not going to bid anymore.

I have just asked our Defense Science Board to update a study on the defense industrial base. We have to regard that as a national asset. And if we can get some stability, that is the key. So I would be delighted to break out the procurement accounts and do anything that might help solve this problem, and we will work with you on that.

Senator DOMENICI. Mr. Chairman, I am going to yield, but I have some additional questions, and even if you cannot stay, if you would permit me to stay.

Chairman CHILES. All right.

Senator DOMENICI. I think Senator Kasten has been waiting.

Chairman CHILES. Senator Kasten.

Senator KASTEN. Thank you, Mr. Chairman.

Mr. Chairman, I would like to just ask one question and then I will put the others in the record.

Chairman CHILES. They will be in the record.[1]

Senator KASTEN. First of all, I apologize for not being here. Some of us have been down, listening, in appropriations. But I want to welcome you.

And if you have answered these questions before, then just tell me, and I can go back to the record. But are there parts of this budget that are specifically detailed or directed toward dealing with the conventional force imbalance that we have in Europe? In other words, by taking the nuclear forces out, the imbalance between the Warsaw Pact countries and the NATO countries becomes more important.

---

[1] See p. 160.

I have been reading that we have got to continue to modernize our conventional forces, or keep up with our R&D efforts. It has all been kind of—I should not say vague—but it hasn't been specific.

Are there certain parts of this budget that are more important than others as we look at trying to do something to restore, or at least to reduce this conventional force imbalance in Europe?

Secretary **CARLUCCI**. It is not, Senator Kasten, broken out in quite that way. But we have in the so-called Byrd-Quayle report, broken out the programs that fit under the Montebello decisions and the conventional defense initiative decisions or programs.

There is funding in the budget for continued modernization of dual-capable aircraft in Europe. There is funding for continued upgrade of nuclear artillery. We do have $15 million in the budget for a follow-on to the Lance system, which would be deployed in 1995. We are looking at different systems that might be appropriate.

There is no money for the tactical air stand-off missile, which was also a Montebello decision, simply because we are still looking at systems.

In the conventional defense initiative, you are talking about air defense upgrades; you are talking about munitions supplies, those kinds of things which fit into the overall context to our budget. Some of that is identified in the Quayle-Byrd report, but not all of it.

Admiral **CROWE**. I would just add one thing, Senator. The overall thrust of the budget is that any cuts, any drawdowns, would not be in those forces, those equipments, and in those dispositions that support NATO.

Secretary **CARLUCCI**. Absolutely.

Senator **KASTEN**. This is going to be a growing debate, and it has started right now. And I guess I am asking this question as much as an appropriator as I am a Budget Committee member. But I think that some of us are going to want to look carefully at this question and the components of it, even if we end up by shifting some other resources.

We will follow up——

Secretary **CARLUCCI**. Well, we can identify the programs—for example FADS is a program that is the very key to our activities in the central front. So we can identify the programs and pull them out of the budget for you.

Senator **KASTEN**. The underlying question—and then I will yield—at the time we made the Montebello and all these other kinds of agreements it wasn't clear at that time we were going to have the INF forces reduced. So some of the decisions that were made at that time, may or may not have been made with the same knowledge and understanding. And I think the conventional force imbalance is more important now than it was even at the point where we reached some of those agreements.

Secretary **CARLUCCI**. We would argue that INF has not altered it, but it has highlighted the importance.

Senator **KASTEN**. Mr. Chairman, thank you.

Chairman **CHILES**. Thank you, sir.

Everyone is talking now about burdensharing. We have talked a lot about NATO and the part that we are playing there, and we have even mentioned Japan.

As far as the Pacific is concerned, our other"Asian tigers" that are there, what kind of role they should be playing, and even some of our European allies? How the hell do they get out of letting us carry every burden in the Pacific? They certainly have some interests there, just like we do.

Secretary CARLUCCI. Well, some of our allies are in the Pacific, like the French and the British, but quite obviously, they don't have the same national security interest that we do in the Pacific. We learned that lesson the hard way. The so-called "Asian tigers" are really—while we have good relations with them and cooperate, they are really not in a position to mount large military operations our of their immediate environs. You are talking about countries as small as Singapore, which has a very capable defense force, by the way, but is relatively limited in scope.

Thailand has its own insurgency problem, so they are obviously occupied with that. Similarly, Malaysia has been going through some economic difficulties lately. Hong Kong is a particular situation with its relationship with China.

So I don't see——

Chairman CHILES. Keep going. You haven't gotten to South Korea.

Secretary CARLUCCI. Well, South Korea, obviously, is a country with considerable economic strength, and they are in a position to pick up over a period of time an increasing share of the burden, and I think we need to work with them on that. But we certainly don't want to repeat the mistakes of the past as far as South Korea is concerned. It is an area of vital interest to us, and we need to handle whatever we do there in a highly sophisticated way.

Chairman CHILES. I understand the problems, and I don't know how to do it, either. So I am not saying that I have any plan. But here we sit with South Korea and we have done a heck of a lot for them. I can remember when I was there, there was not a brick on a brick anywhere except for some places in Seoul. All of the things were made out of tin cans or x-rations or things that we had, all the trees had been cut down. A miracle has happened in that country—and I certainly applaud them for it, because it is just nothing short of a miracle.

We are still quartering troops there. Goodness knows, there is no nation more aggressive than the North Koreans, more of a threat. But the South Koreans now, with four times the GNP, double the population, certainly we know their forces are very well-trained now. We saw how they equipped themselves in Vietnam.

At the time of Korea, I will remember well, they used to relieve a battalion commander with a pistol, and of course, they did not have much in the way of an officer corps or experience. But they have learned now. How can we get something——

Secretary CARLUCCI. Well, the good news is that the Korean forces have done a marvelous job, and they are a highly capable force now, no question about that. The bad news is that they are considerably outnumbered by North Korean forces, and the Soviets have just within the past couple of years moved to help North Korea modernize its aircraft, for example.

So they continue to face an enormous threat just 30 miles from their capitol. Moreover, they are a government that is in the process of replicating their economic miracle with a political miracle. And we certainly did not want to take any precipitous action while the political process was in a state of flux. Once we get a stable government in place, with whom we can have a constructive dialogue, I think we can have a constructive dialogue on respective roles, missions, within the context of our continuing to be committed to a free and democratic Korea. And we are not going to suddently say, well, for budget reasons, we are going to leave Korea. I don't think that is the way to approach it, and I know that is not what you are advocating.

But I think we can have a good and constructive dialogue with the Koreans under the new democratic government.

Chairman CHILES. Admiral Crowe, do you have anything to add to that?

Admiral CROWE. Well, I think that as my net assessment in my statement mentioned, we are steadily improving in that part of the world, Mr. Chairman. And from a military standpoint, we have made remarkable progress, and I am much more comfortable about that part of the world than I am about Western Europe, and I think that allows us some latitute to reassess and to move forward in coming years, with them assuming a larger share of the burden, and with us adjusting accordingly.

One other thing, Mr. Chairman. I believe that part of the thrust on burdensharing, particularly in NATO, must be the theme that our global responsibilities contribute to NATO, no matter how they look at it, that that is a fact of life, and that they benefit from it, and that we should get credit in the alliance circles for what we do globally and the deployments and the investments that we make around the world. And I think we should hammer that theme.

Chairman CHILES. Well said.

Senator Domenici.

Senator DOMENICI. Mr. Chairman, thank you.

Let me say to you, Admiral, last year was the first time I was privileged to read the statement by you, and I don't know if you know that I thought enough of it to put it in the record and to circulate it to all the Senators. I commend you again for this year's statement. As the chairman of the Joint Chiefs, I think you have, at least before this committee, a remarkable ability to explain America in the world, and the risks and the successes and the national security evaluations is an extremely gifted presentation. I only wish that in some way—you can't do it in a simple manner; it has got to be done your way—but I wish more people in this country, especially opinionmakers, would have an opportunity to read it in the context that you deliver it. I appreciate that very much.

Admiral CROWE. Thank you, Senator.

Senator DOMENICI. Mr. Carlucci, let me suggest that as regards the chairman's notions about reprogramming, I share the concerns. I would advise you that as you submit them in detail you ought to make sure that everyone understands what is going to happen if we don't to the reprogramming, because I thing the reprogramming is made absolutely necessary by the dramatic reductions. And if we don't have the reprogramming, we up there ought to understand the multiplying negative effects in our States and at bases around the United States, in the areas that we are already complaining about. And I think in that context, you ought to make sure we understand that.

Secretary **Carlucci**. Well, the choices will be very hard choices. We will have to stop our airplanes farom flying and our ships from sailing, or we will have to lay off substantial numbers of people. It is as clear as that, and all of that will happen at the end of September.

Senator **Domenici**. Now let me move to an issue that concerns me and is admittedly somewhat parochial, and then I am finished.

I want to talk to both of you, particularly you, Admiral, about the three nuclear national laboratories, the deterrent laboratories—Sandia, Los Alamos, and Lawrence Livermore.

First of all, I laud your budget with reference to what I perceive to be an assessment of those national laboratories as a very significant part of our deterrent. You could have assessed it another way, because obviously, it is another department that runs them—the Department of Energy. It is always easier for Defense to say, "That is not our bailiwick; it is poor, old John Harrington, with a dotted line up to a General who reports to you." But you didn't do that; as I understand it, the labs are not going to be dramatically cut while the rest of defense goes up. They are being treated rather evenhandedly.

I want to say to you that I hope as chairman of the Joint Chiefs of Staff that you have had an opportunity to acquaint yourself with the scientific capability of those labs with reference to not only the strategic arsenal, but also the huge scientific and engineering base that is there. And in this fast-changing world, it seems to me that we don't want to let that get away from us and then go out and try to build it up.

So might I just ask you for your observation with reference to that?

Admiral **Crowe**. I agree with everything you say, Senator. This is appreciated among the Joint Chiefs of Staff. I must confess to you that I am not able to acquaint myself as much as I would prefer, but I think the importance in the fact that they are a national asset of the first order, we deeply appreciate.

Senator **Domenici**. I would say to you personally, it would be my privilege if you would join some of us in visiting those laboratories. I really think it is almost impossible, without seeing what is going on, to conceive of their capability.

Senator Nunn, on the authorization side, has seen their potential in nonnuclear activities and is trying to direct some of the R&D toward them in the nonnuclear areas of armaments and the like, where they obviously have tremendous capabilities.

Having said that, let me move to a specific issue that I think applies to the laboratories and is something expanding in this country—the issue of verification.

I am not talking about the assemblage of the team for the verification required under the INF treaty the President signed with the Soviets. I am talking about the science and the strategy of verification for future arms control agreements.

And let me just suggest it is my understanding that the principal research and development has gone on in these national laboratories in the past; that we never negotiate regarding nuclear treaties without the national laboratory scientists being involved in evaluating and assessing.

Now, I want to just urge this—and if you care to comment, fine; if not, it will be my last remarks—I believe that the science and strategy of verification is an evolving thing. I think the marrying up of satellites with other kinds of verification technologies is truly becoming a science. And I urge that we look carefully at whether or not we are getting the kind of consolidation of talent that is necessary to advance the strategy and science of verification. I have a hunch it is spread out too much, and that we ought to take a serious look at whether we want to focus it someplace so that there are incentives to look beyond the immediate needs of verification in an orderly and scientific manner. And obviously, if I believe that, I think it belongs in the Department of Energy where the other nuclear work has been going on, and obviously, centered and focused on the national laboratories.

That is the end of my statement. I would just urge that.

Secretary CARLUCCI. I take your point, Senator Domenici. We are seriously engaged in looking at the science of verification.

I might take advantage of your comments to mention a problem that we have in our own labs, and I am sure it applies to the Department of Energy as well. That is, we are unable to offer the salary scales that will continue to attract scientists and engineers.

We had an experiment at China Lake which was highly successful in putting into practice flexible salary scales. We would like to replicate that throughout DOD as a whole. The alternative might be to put all 75 of our laboratories on government contract status. I don't think that is as desirable an alternative as flexible salary schedules, and if the Congress would be prepared to look at that, we would be delighted to work with you.

Senator DOMENICI. Well, the ones I have referred to are go-cos of one type or another, and I think that accounts for their success. One is nonprofit go-co; the others are in university relationships, where there is no profit, but they are not run by DOD; they are run by other entities—nor are they run by the Department of Energy.

I want to just close by saying that we are going to try very hard on this committee to be helpful. I thank you personally for what you are trying to do.

I assume that is it. The chairman has indicated that we stand in recess until the call of the Chair.

Thank you very much.

Secretary CARLUCCI. Thank you.

Admiral CROWE. Thank you, sir.

[Whereupon, at 12:30 p.m., the committee was adjourned.]

WRITTEN QUESTIONS FROM SENATOR GRASSLEY TO SECRETARY CARLUCCI AND THE RESPONSES

FIVE-YEAR DEFENSE PROGRAM

Question 1. Was the September 1986 version of the fiscal year 1988-92 FYDP used as the basis for formulating the fiscal year 1989 budget request?

Answer. The September 1986 FYDP reflected the program decisions that were made during the calendar year 1986 biennial program review. The fiscal year 1988/1989 biennial budget was formulated on the basis of that program review, and was submitted on January 5, 1987. As a result of the budget summit agreement reached in the fall of 1987, an amended fiscal year 1989 request was submitted on February 18, 1988. In the limited time that was available to reduce the fiscal year 1989 request by $32.5 billion, it was not possible to conduct a program review and make outyear program decisions. Accordingly, no FYDP was produced in conjunction with the fiscal year 1989 amendment.

Question 2. If the September 1986 version of the fiscal year 1988–92 FYDP was used in formulating the fiscal year 1989 budget request, which FYDP was used in formulating the fiscal year 1988 budget?

Answer. As indicated above, the only FYDP used in formulating the fiscal year 1988 and fiscal year 1989 budgets was the September 1986 FYDP.

Question 3. Why did DOD fail to publish the final version of the fiscal year 1988–92 FYDP by February 1987, which would have reflected all the program and budget decisions taken by the Secretary of Defense in connection with the fiscal year 1988 budget submission?

Answer. In the fall of 1986, DOD was faced with formulating its first biennial budget submission in less time than had previously been available to formulate annual submissions. To compensate for the increased amount of review effort required to ensure budget quality estimates for 2 years rather than 1, the outyear impact of fiscal year 1988/1989 budget decisions was not comprehensively addressed during the review. Rather than publish a FYDP containing outyear program data which had not been reviewed and approved, no FYDP was published.

WRITTEN QUESTIONS FROM SENATOR KASTEN TO SECRETARY CARLUCCI AND THE RESPONSES

MILITARY MANPOWER

Question 1. Would you go over how the recent cuts you have made and explain who they make our forces more effective?

Answer. Military manpower for fiscal year 1989 has been reduced from the Department's original fiscal year 1988/89 budget request. Given that we have to absorb significant budget cuts, a smaller but well trained and equipped military force is more effective than a larger but less well trained and supported force. The forces we retained have the resources they need to perform the tasks entrusted to them. Compared to the fiscal year 1988/89 budget request the military manpower reductions are: Air Force, −25,000; Navy, −9,600; Army, −8,600; Marine Corps, −2,900.

MANPOWER REDUCTIONS

Question 2. I have been told that you have also said that if Congress appropriates less than the requested 2 percent real growth for the Department then you would absorb the cuts by additional manpower reductions. Is this true?

Answer. Since the beginning of the budget cycle, I have maintained that the Department will sustain a balanced budget. With less than 2 percent real growth in fiscal year 1989 the Department will have to cut force structure then reduce associated manpower in a balanced fashion.

Question 3. Your current budget calls for a reduction of 36,000 men and women. Approximately, how many more will be if you get zero real growth?

Answer. No specific manpower reduction is associated with zero real fiscal growth in fiscal year 1989. The entire spectrum of defense operations would need to be scrutinized to produce a balanced program reduction of that magnitude. Force levels would decline only as much as necessary to assure that the remaining units are capable of maintaining acceptable readiness levels.

MILITARY POSTURE

Question 4. It has taken seven years and nearly $2 trillion dollars to restore the defense capability we need for our security. I think its great that we have been able to use this posture to be the leader in arms control. Now in only five weeks the fiscal year 1989 defense budget has been reduced by $33 billion dollars. That's over 10 percent of the whole defense budget. How do you plan to maintain our strong posture which is key to future arms control agreements—especially the Strategic Arms Reduction Talks?

Answer. In preparing this budget, I was presented with a difficult task: reducing the defense budget by 10 percent while preserving the gains of the last 7 years and maintaining an essential balance in defense capabilities. In order to minimize the risks, I set clear priorities for the services to follow in making reductions: people, readiness, and efficient acquisition. Entire programs were eliminated, and our force structure reduced. The result will be a smaller force, but a force fully capable of performing its mission. But, although we have tried to minimize the risks resulting from these reductions, our global responsibilities have not been reduced, and therefore this budget requires us to accept a higher level of risk than we think wise.

Over the longer term, we must continue to work toward a concensus on Defense spending, to establish realistic and stable funding for defense programs. Although we all recognize the changes in the economic climate of this country, we cannot allow the erosion in defense spending over the past 4 years to continue without recognizing the long-term consequences that this holds for the security of our nation.

OFFSETTING NUCLEAR DISADVANTAGES

Question 5. Since the beginning of the nuclear era we have based our deterrence on the threat of forces that could be used against us. Our Intermediate Nuclear Forces were installed to offset the conventional and nuclear advantage the Warsaw Pact has over us. Now we're both reducing our nuclear forces—but they still have their conventional forces. What major funding efforts and policy changes are in the 1989 request that would help us offset this disadvantage?

Answer. Our fiscal year 1989 budget continues our on-going commitment to the modernization of our conventional and non-strategic nuclear forces, and especially to the implementation of those improvements relating to the 1983 Montebello Decision and the 1984 Conventional Defense Improvements program. Although most of these are not new initiatives, the signing of the INF treaty has highlighted the importance of continuing these ongoing modernization efforts. To further these modernization efforts, we are requesting that Congress lift the current limitations on nuclear artillery rounds, and remove the restrictions on further development of ATACMs as a follow-on to LANCE. We are also requesting an increased level of funding for NATO Cooperative Programs, as we continue to expand our cooperative development efforts to redress significant deficiencies in our collective conventional defense posture.

We must continue with our efforts to investigate new technologies which will strengthen our capability to conduct a flexible conventional response. Toward this end, we have initiated the Competitive Strategies Initiative, a method of strategic thinking that evaluates our national defense strategy in terms of our long-range relations with the Soviet Union. The Competitive Strategies approach will allow us to respond to changes in the strategic environment in a way which will make the most effective use of our resources. Our initial task force focused on a mid-to high-intensity conflict in Europe, and the task force recommendations are being staffed now, with a view toward the best way to implement them.

WRITTEN QUESTIONS FROM SENATOR LAUTENBERG TO SECRETARY CARLUCCI AND THE RESPONSES

ALLIES SHOULD UP THE ANTE

Question 1. You are no doubt aware that in 1977 our NATO allies made a commitment to increase common defense spending in real terms by 3 percent above inflation yearly. While the United States has continually exceeded the 3 percent level, our allies have not come close. According to the Congressional Budget Office, the United States has increased defense spending in real terms by an annual average of 5.7 percent under the Reagan administration. But our NATO allies, on average, have increased spending by only 2 percent.

Don't you think the administration should have been more aggressive in encouraging our allies to up the ante on their share of the defense burden?

Answer. The administration has consistently encouraged our allies, in various fora, to assume a greater share of the common defense burden. However, the situation is not as bleak as your question suggests. As our annual "Report on Allied Contributions to the Common Defense" makes clear, the allies are doing much better than is commonly recognized. The data you cite on defense spending are only part of the picture. National contributions to the common defense assume many forms, and there is no universally accepted formula for calculating each country's "fair share."

At the same time, data on defense spending must be put in proper perspective. Although the real increases in U.S. spending exceeded by a wide margin the average growth rates of non-U.S. NATO defense programs during the early through mid-

1980's, the high U.S. growth rates in those years reflected in part an effort to compensate for the real decreases and low growth rates we experienced during most of the 1970's, when our allies were achieving steady real increases. Accordingly, U.S. cumulative real defense spending for the early 1970's through the mid-1980's was approximately what it would have been if U.S. defense spending had declined by a uniform annual rate of roughly 1 to 2 percent each year during that period. A comparable computation of real defense spending for the non-U.S. allies results in a uniform annual rate of plus 2 percent.

BURDENSHARING COULD PROVIDE COUNTERPRODUCTIVE

Question 2. How could the administration have been more effective in reducing the disparity without jeopardizing the security of America and our allies?

Answer. You correctly suggest that some measures to encourage greater burdensharing could prove counterproductive and jeopardize the U.S. national security. This is especially true of punitive measures such as U.S. troop withdrawals from Europe. For example, major troop withdrawals would seriously exacerbate NATO's conventional inferiority vis-a-vis Warsaw Pact forces; undermine NATO's initial defense capability without which crucial reserve and reinforcement units could not be brought to bear; and force greater reliance on early use of nuclear weapons in response to conventional aggression. Substantial unilateral troop withdrawals would also devastate our negotiating leverage in conventional arms reduction talks, and thoroughly demoralize our allies, who would be likely to reduce their own efforts as a consequence.

ASSUMING LARGER SHARE OF BURDEN

Question 3. There has been strong support in the Congress for increased burden sharing by our allies. Would you agree, however, that success in getting our allies to assume a larger share of the burden depends primarily on diplomatic initiatives of the executive branch?

Answer. While the executive branch is inevitably in the lead on a day-to-day basis with our allies, congressional support for increased burdensharing can play a useful role. For reasons already suggested, punitive congressional action will not likely elicit a positive allied response. Positive incentives for increased contributions are another matter. For example, the Nunn and Quayle amendments of 1985 have served as a valuable impetus to cooperative armaments development programs with our NATO allies. These programs help to increase efficiency in the use of alliance resources and to minimize wasteful duplication of effort. To date, 12 memoranda of understanding have been signed, addressing a variety of projects that will significantly improve U.S. and allied defense capabilities.

SUCCESSES AND FAILURES OF DEFENSE BURDEN

Question 4. As Secretary of Defense, please describe the efforts of the Reagan administration to get our allies to assume a larger burden. What were our greatest successes and failures in this area? Why?

Answer. Again, we have consistently encouraged our allies to assume a greater share of the common defense burden. The successes and failures in this regard cover a wide range of defense issues that are part of our daily agenda with each allied nation. The best source for an overview of the situation is our annual "Report on Allied Contributions to the Common Defense."

I would like here to underscore a recent example of a mjaor burdensharing success; that is, the INF Treaty. The unity and resolve that the European allies showed in staying on course in the deployment of intermediate-range nuclear forces were absolutely critical to the outcome of the INF negotiations. In particular, the governments of the United Kingdom, Germany, Italy, Belgium, and The Netherlands withstood intense pressure to alter their decisions to base INF missiles. Without their steadfast support and willingness to share the political burden of INF deployments, the December 1987 INF Treaty would not have been possible.

As to the reasons for burdensharing successes and failures, much depends on the specifics of each case. But in general, we are most successful when the benefits of burdensharing are perceived as mutual and in the national interests of both parties.

DISPARITY WILL NOT GROW

Question 5. The Department of Defense and Congressional Budget Office agree that the United States is paying for a larger share of the burden. Both have recently reported that based on a number of economic and military measures, the United

States is doing more to contribute to common defense than almost any of its allies relative to its economic strength.

Will increases in conventional defense expenditures that will most likely result from the INF Treaty cause the disparity between our defense spending and that of our European allies to widen?

Answer. With regard to reports that show that the United States is doing more for the common defense "than almost any of its allies," I would again refer you to our annual "Report on Allied Contributions to the Common Defense." The report finds that while the United States is clearly doing more by some numerical comparisons, we are not in the lead by other comparisons. For example, in terms of actual contributions versus ability to contribute, several allies do better than we in areas such as manpower, division equivalent firepower, and tactical combat aircraft. I would note that the Congressional Budget Office, in an evaluation of our 1987 annual "Report on Allied Contributions to the Common Defense," found that it "draws reasonable and fair conclusions as to the performance of individual nations."

Your question suggests that the INF Treaty will result in increased conventional defense expenditures. But there is no need for major spending increases in the conventional area as a result of the INF Treaty. Rather, the need is to continue with programs that pre-date the INF Treaty, such as the 1984 NATO program for Conventional Defense Improvements. As to the disparity between our defense spending and that of our European allies, it will not grow in the near term. Quite the contrary, since several allies plan to increase their defense spending in 1988 while our defense spending is projected to decline.

COMMITMENTS BEING SOUGHT

Question 6. What specific commitments should we seek from our allies to meet this growing challenge?

Answer. We are now working with our allies to increase their individual and collective efforts and to improve the efficiency with which the Alliance uses the resources available to it. I called on my Ministerial colleagues at last fall's Defense Planning Committee (DPC) meeting to explore with us new ways of approaching the burdensharing issue that will safeguard our collective ability to maintain over the long haul an adequate defense posture. The President likewise asked his colleagues at the recent NATO Summit to redouble their efforts to ensure that the burdens of defense are fairly shared and to make more innovative and efficient use of resources.

I intend to follow up personally on this issue and to press at every opportunity for progress in improving allied defense capabilities and in sharing equitably the roles, risks, and burdens of the Alliance. To assist in this effort, I have created a Special Task Force to develop and coordinate specific initiatives to be undertaken in conjunction with our allies, with the specific intent of equitably strengthening our collective defense effort. I am also undertaking to obtain the counsel of prominent individuals outside government, who have in-depth experience in cooperative endeavors with our allies. We hope to report further progress by the end of the year.

DIFFERENTIATION NOT POSSIBLE

Question 7. Please describe the U.S. Army's efforts to secure West German support for MRP.

Answer. A review of historical documents could not differentiate between the U.S. Army's efforts and the Joint Services' efforts. In addition, concurrent efforts were ongoing at the technical staff level while the leadership pursued German counterpart support. The review did determine that during the period March 1982 through March 1984, seven sessions of U.S. and German talks, and discussions involving the President, SECDEF, SECSTATE and their German counterparts occurred.

LACK OF FUNDING

Question 8. Why have they failed?

Answer. The principal obstacle to MRP was the refusal of the Federal Republic of Germany (FRG) to fund it. The FRG was concerned that support of this initiative would set a precedent which other NATO member states could exploit. Specifically, it would open FRG up to demands by other nations for bilateral funding of their requirements. In addition, previously agreed on infrastructure funding priorities were competing for limited German Ministry of Defense (MOD) funds.

FUTURE EFFORTS FRUITLESS

Question 9. Do you have reason to believe that future efforts would meet with more success?

Answer. Based solely on the above two FRG objections, there is no reason to believe that renewed efforts would meet with success.

VIEWS OF THE SECRETARY OF STATE

THURSDAY, MARCH 17, 1988

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 9:45 a.m., in room SD-608, Dirksen Senate Office Building, Hon. Lawton Chiles (chairman of the committee) presiding.

Present: Senators Chiles, Hollings, Sasser, Lautenberg, Sanford, Wirth, Conrad, Domenici, Grassley, Kasten, Quayle, Nickles, and Thurmond, ex officio.

Staff present: Richard N. Brandon, staff director; and Douglas Olin, assistant director for budget systems.

For the minority: G. William Hoagland, staff director; and Charles Flickner, senior analyst for international affairs.

OPENING STATEMENT OF CHAIRMAN CHILES

Chairman CHILES. Good morning, Mr. Secretary, we are pleased you could be with us today. It is nice of you to share St. Patrick's Day with us. To say you have a full agenda would be a major understatement. I do not know how you fit so many hours into a 24-hour day.

Your appearance before the Budget Committee, of course, is to talk with us about the international affairs budget. I am sure that we will also want to get into a discussion about what is happening in Central America and in the Middle East.

First, I want to take this opportunity to compliment you on the budget you have proposed for this year. We see that in contrast to last year's budget, foreign affairs funding this year is for 2 percent growth in discretionary spending. Certainly, this is in keeping with our bipartisan agreement. I know you would like to see that figure be higher, but it is also a recognition that the increases of the past years could not continue if we are serious about reducing our Federal deficit.

This year's international affairs funding debate will not focus on the top line. The Budget Summit determined that last December it is going to focus more on how funds are to be spent between the $18.1 billion available for discretionary programs within this function. In a sense, it will be a breathing space and time for debate about priority and effectiveness, a debate which I expect will continue into the next administration, a debate which will be tempered, I suspect, by the events that are unfolding around us.

I wish we could devote more resources to the foreign affairs function. Foreign assistance to our allies strengthens our own interests.

We in Congress know this. That is why we have supported the nearly 50-percent increase in the funding of these programs over the past 7 years. But the time of the sharp annual growth is over, and it is time that we begin to reevaluate the role, form and effectiveness of our foreign assistance program.

We have to ensure that our moneys will be well spent. We need to sustain funding levels adequate to deal with our commitments abroad, and we need to provide resources to meet our foreign policy objectives. And we need to develop a truly bipartisan foreign policy.

I had hoped that we would use today's hearing to be a little more philosophical about the future directions of foreign policy and the management of the State Department. With last night's decision to introduce over 3,000 troops to Central America and the deteriorating situation in Panama and growing differences between the administration in Israel concerning the Palestinians, I think that it is certainly appropriate we begin the hearings with a discussion of the present situation and the immediate future.

Specifically, Mr. Secretary, I hope you will tell us in your opening statement about the troop commitments we are making in Honduras, what was the situation in which they were introduced, what will their mission be, how long will they remain, and what limitations are being placed on their deployment.

I know that you have to leave. In the aftermath of the tragedy in Beirut, then-Secretary of Defense Caspar Weinberger laid down a set of principles to be used governing the commitment of U.S. forces into potential combat situations. Those principles included that the United States should not commit forces unless the issue is deemed of national interest. If we commit troops, we should do so wholeheartedly, with the intent to win. We need clearly defined military objectives and an understanding of how our forces will carry out those objectives. We need to match up the relationship between our forces and those objectives. And before the United States commits forces abroad, there has to be a reasonable assurance they will have the support of the American people and their elected representatives, and finally, the commitment that U.S. forces should be a last resort and only after other resources have failed.

I do not know whether those same principles are being followed here, whether the situation is the same, but perhaps you will comment on that.

I know that you will keep your prepared remarks short so that we can ask questions again. As I picked up the Washington Post today and looked at all of the events that were there, I want to tell you the one thing that was reassuring to me is that you are Secretary of State and that I have got you to worry about some of those problems, and I do not have to worry about all of them myself.

Senator Domenici.

OPENING STATEMENT OF SENATOR DOMENICI

Senator **Domenici**. Thank you, Mr. Chairman.

Secretary Shultz, I wholeheartedly concur in the opening remarks of our chairman. I would just like to say that the events of the day have probably somewhat overtaken the normal aspects of this hearing. We were obviously going to go into the issue of where is our foreign policy headed in terms of foreign aid programs, both military assistance and non-military assistance. And obviously some of us are genuinely concerned about the flow of drugs from some of our friendly countries, those that we have helped, those that we have nourished into a democratic posture. We are very worried about what is happening on the streets of the United States and to our young people with reference to drugs.

Even though we do have the other issues confronting us, both Central America and the Middle East, I do hope before we finish today we will be able to address that issue a bit with reference to your views on the enormous flow of drugs and drug czars that exist in many of the countries that are our friends and allies and that we have helped.

Suffice it to say that I, too, am very proud of what you have done. I hope today you will give us and, in a sense, the American people a very current evaluation of the situation in Central America. And, hopefully, we can talk also about the Middle East.

I thank you for your appearance, and we look forward to hearing from you. Thank you, Mr. Chairman.

Chairman CHILES. Thank you, sir.

Mr. Secretary.

STATEMENT OF HON. GEORGE P. SHULTZ, SECRETARY OF STATE

Secretary SHULTZ. Thank you, Mr. Chairman and members of the committee. I appreciate the chance to appear before you——

Chairman CHILES. Pull your mike up just a little bit more if you would, sir.

Secretary SHULTZ [continuing]. To support the President's foreign affairs budget request. I have a fairly lengthy piece of testimony here, and with your permission, I will put it in the record and spare you reading through it.

Chairman CHILES. Thank you, Mr. Secretary. It will be included.[1] That is agreeable all around, I am sure.

Secretary SHULTZ. I would like to make a few comments, however, at the beginning and then have questions.

First of all, as far as the amount of money in the 150 function is concerned, as you suggested, I believe it is inadequate from the standpoint of our opportunities and our needs around the world. The administration and the Congress worked hard last year and reached an agreement at a Budget Summit, and so out of that came some numbers. And we have worked faithfully within the framework of those numbers as you suggested. We have made the allocations to the best of our ability to deal with the sums that are available.

I would like to take the opportunity, while saying that I consider the funds to be inadequate, to thank the members of this committee because I know that you have worked hard on this. And if it had not been for your efforts, the numbers would be worse. So on the one hand, they are inadequate. On the other hand, I want to thank you for the efforts that you all have made.

---

[1] See p. 172.

Obviously, the numbers, the amounts of money, are one thing, but what we are interested in is what is supposed to be accomplished with this money from the standpoint of the United States. What is the point of it all?

Clearly, there we have to consider our security, our prosperity, our ideals and ideas and the importance to us, as well as to others, of movement in those directions around the world. I think we are making a lot of headway; and while there are immense problems all over the place, nevertheless the things that America has stood for are gaining ground. And I think the picture, taken broadly, is a very good one. So it is a moment when we have the opportunity to use resources effectively.

We could go around area by area, and I will not do that except in response to your questions. With one exception, I would like to make some comments on the Middle East, and then take questions on the other areas of your interest.

But let me single out, before talking about the Middle East, the subjects of terrorism and drug trafficking because these are subjects that we have all been concerned about for a long time. I think there is no set of subjects that I have personally spoken more passionately about than these problems. I believe we have made some headway, but we have a long ways to go.

Everybody, I read in the papers—and I am not a political—I do not run for office like you do, but I read in the papers everybody is knocking the presidential campaign, and all the pundits say it does not amount to anything and nobody talks about any issues. But I would like to single one out that I think is getting attention, and that is the drug problem. I think the more attention it gets, the more we are brought to understand the depth and seriousness of this problem the better.

From the State Department's standpoint, we work on the international aspects of it as part of an integrated approach and try to work with other countries to eradicate drugs, to get after the laboratories where they are produced, to interdict and all of that sort of thing. We have a much more active program than we had a few years ago, and we can point to all kinds of successes, so to speak. And yet the problem is there. The volume and the flows are great, and we have to recognize that it is a huge, huge difficulty.

I will illustrate it by a couple of numbers. Last year, in cooperation with the Government of the Bahamas, our embassy work there coordinating with the Drug Enforcement Administration and the Customs, we managed to get $5 billion worth of cocaine, to interdict that. It is a gigantic sum of money.

Now, what is the GNP of the Bahamas? Nobody really knows. It is not counted in quite the same way we go about ours. I would say at the outside it is $2 billion; it is probably closer to half that, but say $2 billion. When you think of the amount of drug money running around in comparison with the normal pattern of life, you see the threat to civilized society that is posed by this menace. Of course, we see it in Colombia, we see it all around.

So I just want to put in one plug for the presidential campaign because it does seem to me, as I have watched pictures here and there on television, that the nature of the drug problem has been getting a little bit of highlighting. And personally, I am glad to see it. If people like to belabor me for not doing enough and that helps, it is all right with me. I do not think anybody is doing enough, frankly, and we have to get after this problem.

Let me just now make a few remarks about the Middle East and then have questions. We are engaged intensively in an active process to achieve a comprehensive peace in the Middle East through negotiations. This is a time for decisions. The situation on the ground does not serve anyone's interest. Rapid, positive change can occur.

My discussions with the leadership in Israel, Jordan, Syria and Egypt and our talks this week in Washington with Israel Prime Minister Shamir focused on the need for realism and movement in the peace process. The initiative we developed, which the parties are now considering, is ambitious and compelling. It calls for an early start to two sets of interlocked negotiations: one on transitional arrangements, and another on final status. The final status talks would begin on a date certain before implementation of the transitional arrangements. Both of these negotiations will be launched by a properly structured—I want to underline those words—properly structured international conference.

I should say that final status talks as set out in our initiative would start before the transitional arrangements are implemented but after they have been agreed to, and decisions about final status would take place only well after the transition arrangements had been in place and people had an opportunity to see how they worked.

Questions have been raised about such an international conference, and I want to make clear what it is that we have proposed. The United States has been a consistent and firm supporter of direct bilateral negotiations between Israel and all of its neighbors as the means to achieve a comprehensive peace. The United States has always been willing to consider any approach which could lead to direct negotiations, including an international conference. The United States opposes and will not participate in an international conference designed to replace bilateral negotiations.

In recent months, some parties have focused on an international conference which would have an authoritative role or plenipotentiary powers. In January 1988, the United States vetoed a resolution in the United Nations Security Council which called upon the Secretary-General to convene such a conference. The United States made clear its opposition to any procedure for achieving comprehensive peace in the Middle East other than direct, face-to-face negotiations.

The initiative recently launched by the United States aims at comprehensive peace through bilateral face-to-face negotiations in which all participants state their willingness to negotiate with one another. In other words, if you want to come to the table, you have got to state your willingness to negotiate with Israel. That is by way of recognizing the existence of Israel and the continued existence of Israel.

The procedures in this initiative constitute an interlocked set of safeguards designed to promote such negotiations and prevent a plenipotentiary conference. But these procedures also recognize that the Arab parties require a conference to launch negotiations, and that, therefore, there will be no negotiations without a properly structured conference.

The strength of the American approach is its integrity. No individual aspect of it can be extracted, finessed, or ignored without sacrificing its balance. I have said this is not a cafeteria line. This is a set of things that you have to look at together. The conference launches a series of bilateral negotiations and thereafter may receive reports from the parties on the status of negotiations in a manner to be agreed by the parties. All conference attendees will be required to accept United Nations Security Council Resolutions 242 and 338 and to renounce violence and terrorism. The conference will be specifically enjoined from imposing solutions or vetoing what had been agreed bilaterally.

The United States is committed to the concept for beginning bilateral negotiations which has been shared with the parties. More than shared with the parties, we had an immense series of discussions out of which we developed these proposals. So we did not just go into a hole some place and think this up. We talked and talked and talked and talked, and tried to present something that we thought might work.

The United States will not permit any aspect of its proposal to be eroded or compromised. As regards the conference, the United States will not permit the conference to become authoritative or plenipotentiary or to exceed its jurisdiction as agreed by the parties. We would expect, if our initiative should be accepted, that people in coming to the conference, would have agreed to these terms. If they do not agree to the terms, then we do not have the conference. And if they try to change them after the conference is convened, then we do not go along with that.

So we are being very clear and very specific and very up front about what this conference is and what it is not. But the procedural aspects of this plan should not obscure our objective: a comprehensive peace.

Israeli security can be enhanced. Israel can enjoy the recognition and respect which flow from negotiations. Israelis can be free from the increasing human and moral burdens of occupation, free to devote their considerable talents and energies to improving their quality of life. Most important, Israel can achieve peace with its neighbors.

Palestinians can achieve rapid control over political and economic decisions which directly affect their lives. That could happen right in the transition arrangements. It could happen, I think, quite rapidly if we could get ourselves started. Palestinians can participate actively in negotiations to determine their political future. Palestinians can achieve their legitimate rights and live lives of dignity and self-respect.

The Arab world can turn a corner by resolving this festering conflict. The refugee problem can be solved. A stable new environment can be created in which the human and economic resources of the Middle East can flourish.

This is a moment of testing for the leaders of the Middle East. All must face up to the challenge of peace and beat back the forces of radicalism. Violence and threats of violence achieve nothing. They stand in sharp, empty contrast to what negotiations can accomplish.

The only things that have worked have been negotiations. Negotiations have brought about progress in the Middle East. Nothing else has. No resolution of this conflict can fulfill all dreams. Compromise is required. The plan we have put forward is compelling. It is an integral whole. We have asked for decisions soon so that we can proceed rapidly toward a comprehensive peace.

Thank you, Mr. Chairman. I would be glad to have your questions.

Chairman CHILES. Thank you, Mr. Secretary. I know that we want to ask questions on that.

[The prepared statement of Secretary Shultz follows:]

PREPARED STATEMENT OF HON. GEORGE P. SHULTZ, SECRETARY OF STATE

Mr. Chairman, I am pleased to come before the Committee to discuss our FY-89 budget request. It is an austere request that complies with both the letter and the spirit of the Budget Summit compromise. If this Administration and the coming Administration are to do the job we must do in today's turbulent, complex and changing world, we will need every cent we are asking for -- and we will need much greater latitude in applying those appropriated funds.

For the sake of our national well-being and for the sake of our most cherished values, America must remain a fully engaged force around the globe for peace, prosperity, democracy and humanitarian values.

At the core of our diplomacy are our efforts -- both bilateral and multilateral -- to ensure the strength and unity of our alliance relations, the effective management of East-West issues, the peaceful resolution of regional conflicts and the advancement of our broader security and economic interests.

None of that will be possible if we fail to provide the resources that give substance to our words, lend credibility to our commitments and permit the effective execution of our plans.

Our Foreign Policy Agenda

The Reagan Administration is committed to a busy and challenging foreign policy agenda in 1988. We know that the United States cannot afford the luxury of any letup in our leadership. The realities of our time also dictate that the United States cannot achieve our interests and objectives alone, nor can we do so with insufficient resources. Other countries around the world cannot adequately protect their security, ensure their domestic welfare or protect their democratic institutions absent the active support of the United States. That is why President Reagan has worked so hard to ensure that our European alliance is strong and vital and why we have also strengthened our crucial security and economic relationships in Asia and elsewhere in the world -- relationships that will be crucial to global prosperity and regional security well into the next century.

A brief review of just some of the major issues confronting our world demonstrates the critical need for an engaged, active and effective America:

East-West Relations. The importance of worldwide U.S. engagement came through loud and clear to the President during his recent meetings with his NATO counterparts. In Brussels, we and our NATO partners agreed that if we expect to advance our interests further with the East, we must demonstrate our resolve and be prepared to commit the necessary resources, just as we did in our pursuit of the INF Treaty. Our achievement of that Treaty offers convincing proof that success in advancing our peaceful objectives depends not only on military strength and alliance cohesion, but also on the political will to provide the means necessary to meet our objectives. We trust that the Senate will exercise its advise and consent role and ratify the INF Treaty, signed in December by President Reagan and General Secretary Gorbachev.

Through strength and steady determination, the United States and our allies have set in motion a number of other efforts that with Soviet cooperation, would bring major strides toward a safer, more secure and more humane world. With the Soviets, we will continue to pursue vigorously human rights issues, both as they relate to individual cases and to principles enshrined in the Helsinki Final Act and other international human rights instruments.

On regional conflicts, our policy of matching diplomatic perseverance with military strength has increased the odds for negotiated settlements:

-- The U.N.-mediated negotiation on Soviet withdrawal from Afghanistan is at a critical stage. After eight long years, the courage and tenacity of the Afghan Resistance and people may be about to pay off. We shall stand firm until the Soviet agreement to withdraw rapidly from Afghanistan becomes a reality, and obligations to cease military assistance are symmetrical. The principles of non-interference and non-intervention, so central to a negotiated agreement, require balance and reciprocity in order to bring peace and stability to Afghanistan and to return Afghanistan to the control of Afghans, five million of whom will need assistance returning to their devastated homeland from refuge nearby.

-- We will also make clear to the Soviets our determination to support those fighting for their freedom in Nicaragua, Angola and Cambodia until peaceful settlements are a reality.

Meanwhile, with NATO we are striving for additional progress in arms control according to NATO's agreed priorities:

-- We will press ahead with the strategic arms reduction talks (START).

If the Soviets are prepared to match our efforts, a verifiable agreement leading to a dramatic 50 percent reduction in strategic nuclear weapons will be possible. However, we will not bargain away the extra margin of future safety contained in the Strategic Defense Initiative;

-- We will work to eliminate conventional disparities in Europe;

-- And, we will continue efforts toward a truly verifiable global ban on chemical weapons.

The Middle East. We are engaged intensively in an active process to achieve a comprehensive peace in the Middle East through negotiations. This is a time for decisions. The situation on the ground does not serve anyone's interests. Rapid, positive change can occur. My discussions with the leadership in Israel, Jordan, Syria and Egypt - and our talks this week in Washington with Israeli Prime Minister Shamir - focussed on the need for realism and movement in the peace process.

The initiative we developed, which the parties are now considering, is ambitious and compelling. It calls for an early start of two sets of inter-locked negotiations -- one on transitional arrangements and another on final status. The final status talks would begin on a date certain, before the implementation of the transitional arrangements.

Both of these negotiations will be launched by a properly-structured international conference.

Questions have been raised about such an international conference. I want to make clear what it is that we have proposed.

The United States has been a consistent and firm supporter of direct, bilateral negotiations between Israel and all of its neighbors as the means to achieve a comprehensive peace. The United States has always been willing to consider any approach which could lead to direct negotiations, including an international conference. The United States opposes, and will not participate in, an international conference designed to replace bilateral negotiations.

In recent months, some parties have focussed on an international conference which would have an authoritative role or plenipotentiary powers. In January 1988, the United States vetoed a resolution in the United Nations Security Council which called upon the Secretary General to convene such a conference. The United States made clear its opposition to any procedure for achieving comprehensive peace in the Middle East, other than direct, bilateral, face to face negotiations.

The initiative recently launched by the United States aims at comprehensive peace through bilateral, face to face negotiations, in which all participants state their willingness to negotiate with one another.

The procedures in this initiative constitute an inter-locked set of safeguards designed to promote such negotiations and prevent a plenipotentiary conference. But these procedures also recognize that the Arab parties require a conference to launch negotiations, and that therefore there will be no negotiations without a properly-structured conference.

The strength of the American approach is its integrity: no individual aspect of it can be extracted, finessed or ignored without sacrificing its balance. The conference launches a series of bilateral negotiations and thereafter may receive reports from the parties on the status of negotiations, in a manner to be agreed by the parties. All conference attendees will be required to accept United Nations Security Council Resolutions 242 and 338, and to renounce violence and terrorism. The conference will be specifically enjoined from imposing solutions or vetoing what had been agreed bilaterally.

The United States is committed to the concept for beginning bilateral negotiations which has been shared with the parties. The United States will not permit any aspect of its proposal to be eroded or compromised. As regards the conference, the United States will not permit the conference to become authoritative or plenipotentiary, or to exceed its jurisdiction as agreed by the parties.

But the procedural aspects of this plan should not obscure our objective -- a comprehensive peace.

- Israeli security can be enhanced. Israel can enjoy the recognition and respect which flow from negotiations. Israelis can be free from the increasing human and moral burdens of occupation -- free to devote their considerable talents and energies to improving their quality of life. Most important, Israel can achieve peace with its neighbors.

- Palestinians can achieve rapid control over political and economic decisions which directly affect their lives. Palestinians can participate actively in negotiations to determine their political future. Palestinians can achieve their legitimate rights and live lives of dignity and self-respect.

- The Arab world can turn a corner by resolving this festering conflict. The refugee problem can be solved. A stable new environment can be created in which the human and economic resources of the Middle East can flourish.

This is a moment of testing for the leaders of the Middle East. All must face up to the challenge of peace and beat back the forces of radicalism. Violence and threats achieve nothing. They stand in sharp, empty contrast to what negotiations can accomplish.

No resolution of this conflict can fulfill all dreams. Compromise is required. The plan we have put forward is compelling. It is an integral whole. We have asked for decisions soon, so that we can proceed rapidly toward a comprehensive peace.

The Western Hemisphere. In Central America, we must continue our strong and determined efforts for democracy, development and security. The severe problems in Panama and Nicaragua should not obscure the fact that our longstanding efforts in the region have had impressive results. Ten years ago, Costa Rica was the region's only civilian-led democracy. Today, the military dictators who ruled three of the other four countries are gone. These countries -- El Salvador, Guatemala and Honduras -- are moving in Costa Rica's direction; with increasingly open societies and with civilian presidents chosen in competitive elections.

We must ensure that this encouraging trend continues. What we face in Panama is a threat to democracy; a threat to our ability to stop the international drug traffickers; a threat to the safety and stability of this hemisphere. We will not shirk our responsibility to defend ourselves against this triple threat -- to stop the drug dealers, the terrorists and the tyrants.

We support the government of President Eric Arturo Delvalle.

As President Reagan said last Friday, we believe that General Noriega would best serve his country by complying with the instruction of President Delvalle to relinquish his post. Yesterday's events do not lessen our view that the earlier Noriega leaves, the better Panama's interests will be served. We will continue to fulfill our obligations under the Canal treaties and cooperate with President Delvalle and his government. And, we are prepared to resume our close working relationships with the Panamanian Defense Forces once civilian government and constitutional democracy are reestablished. Once Panamanians achieve these goals, we will work with them to help restore Panama's economic health.

Elsewhere in the Western Hemisphere, we can take pride in the progress of democratic leaders and groups in combatting illegal drug dealers, communist insurgencies and other enemies of peace and freedom. We must continue to support their struggles.

Regarding Nicaragua, it is time for the Congress to sit up and take notice: the Sandinistas are brutalizing their own people. In February, Violetta Chamorro, the head of Nicaragua's leading opposition newspaper, wrote President Arias that: "the Sandinista regime, taking advantage of the suspension of military actions by which it had been besieged, has entered into a phase of total indifference" to the terms of the Guatemala Agreement. This week, Sandinista attacks against the Resistance and into Honduras threaten to spread the conflict.

Those who may have believed that cutting off aid to the freedom fighters would help achieve peace and freedom have made a grave mistake. They must undo the error before it is too late.

Persian Gulf. Elsewhere in the world, an engaged U.S. presence and our sustained support remain essential to international stability and well-being. We are continuing our active efforts to staunch the flow of arms to Iran and ensure freedom of navigation in the Persian Gulf. We remain at the forefront of the international effort in the U.N. Security Council to bring an end to the Iran-Iraq war in accordance with Resolution 598 developed last July. We are working actively within the Council to adopt an arms embargo resolution against Iran as long as it refuses to comply with Resolution 598, which demanded an immediate ceasefire and withdrawal without delay to international borders. We are deeply disappointed that the Soviet Union, which supported Resolution 598, has not been willing to join us in this effort.

South Africa. In South Africa, our goal remains the rapid and peaceful demise of apartheid, the principal source of South Africa's problems and of instability in the Southern African region as a whole. To that end, we are working to foster negotiations among all elements of South Africa's population that will lead to the creation of a democratic society with equal rights for all.

At a time when the repressive actions of the South African government are stifling the interplay of ideas so essential for the evolution of a free society, and isolating South Africa from the free world, we must do all we can to keep dialogue alive and new ideas coming in. Despite the recent serious escalation of repression in South Africa, we remain firm in our belief that this can best be accomplished through a mix of diplomatic and political pressures on the one hand and a series of positive initiatives on the other.

Asia. The strength of our security and economic relationships in Asia will be crucial to regional security and global prosperity well into the next century. In East Asia, the remarkable worldwide trend toward democratic government has borne fruit in the Philippines and South Korea. We must actively support them if these democracies are to thrive and to grow. And, we must sustain our support for ASEAN and the Cambodian non-communist resistance in their efforts to bring about a political solution to the Cambodian conflict encompassing a complete Vietnamese troop withdrawal from Cambodia and self-determination for the Cambodian people. The recent visit of Chinese Foreign Minister Wu testifies to the continued positive development of our bilateral relationship with the Peoples' Republic. China's increasingly open economy and reliance on market approaches are ensuring China's economic development and integration into the global economy.

Global Issues and Concerns. Promoting domestic prosperity is a central foreign policy objective.

It used to be said that when the U.S. sneezed the rest of the world got pneumonia. Now, it works the other way too. Our own economic fortunes have always been closely linked to conditions in the world economy. This is especially true now that economic and technological changes have turned the world trade and financial system into a single, integrated global marketplace. A healthy, growing world economy is thus more than ever vital to our own prosperity. Not only do we have a stake in the strength of the economies of Europe and Japan. Increasingly important is the economic health of the developing counties in Latin America, Africa, and elsewhere in Asia as well.

And, especially now, when the dangers of terrorism and the broad range of threats to many societies posed by international narcotics trafficking are becoming so stark, we must marshal the means necessary to counter these assaults on human dignity and civilized society. I have committed the Department of State -- and you have my personal commitment -- to use every opportunity and all our resources to combat these twin scourges.

As you can see, our foreign affairs agenda is a full one. The daily effort to defend our security, to establish more stable and workable relations with our adversaries, to ensure continued economic growth and to achieve negotiated settlements in strife-ridden areas is a costly exercise. But, instability, stagnation, repression and war are even costlier, and not just in monetary terms.

Yet, just when the need for effective U.S. leadership in the world is increasing and we are scoring remarkable successes, we find that we lack adequate means and enough flexibility either to advance our interests or to meet our commitments to friends and allies.

Overview of our Funding Request

For foreign affairs, or Function 150 in toto, we seek $18.1 billion in discretionary spending authority for FY 1989. This represents the Budget Summit agreed increase of 2 percent over the amount made available to us in the FY 1988 continuing resolution. It is 2.9 percent less than the actual amount appropriated in FY 1987, including the Central America portion of the supplemental. In fact, keeping in mind the decline in the value of dollar overseas, the real value of the resources we commit for foreign affairs is worth less than last year's amount.

Our request for FY 1989 has two major parts. First, bilateral and multilateral foreign assistance. The $14.4 billion in discretionary funds we are seeking under this heading help our friends and allies, but, first and foremost, they serve America's own interests abroad. Of that amount:

o -- $5.3 billion - or 37 percent - is for Israel and Egypt;

o -- $1.4 billion, or 10 percent is for four NATO allies - Spain, Portugal, Greece and Turkey plus the Philippines;

o -- Of the remainder, assistance to Pakistan, Thailand, Kenya, Somalia, Tunisia, Jordan, Oman and Morocco takes another $1.1 billion, or 8 percent;

o -- Assistance for Central America accounts for approximately $900 million, or 6 percent;

o -- Our request for Africa is $818 million, or 6 percent of the total;

o -- And, all other bilateral country programs constitute $800 million, or 6 percent of the total resources requested in foreign assistance.

In addition, the foreign assistance account includes $1.3 billion in contributions to the multilateral development banks, or 9 percent of the total going for foreign assistance; and the remaining $2.7 billion, or 18 percent, for such items as AID central programs and operating expenses, voluntary contributions to international organizations and programs, narcotics control programs, the Peace Corps, refugee assistance and Exim Bank.

The second part of the President's budget request for the foreign affairs function finances the operations of the Department of State, USIA, the Board of International Broadcasting, and other smaller foreign affairs agencies. We are seeking $3.8 billion for these purposes. Out of this sum, we also pay our assessed contributions to the United Nations and other international organizations (including the World Health Organization, OECD, NATO and the OAS), peacekeeping activities, and U.S. participation in multilateral international conferences.

Let me emphasize once again that this modest request in no way reflects any diminution in the scope of our foreign affairs interests, or in the depth of our commitments to friends, allies, and the international system. Rather, our very tight request reflects a compromise between our foreign policy needs and our recognition that we must play our part in reducing the budget deficit.

Let me try to put this discussion in a broader perspective by describing how the foreign affairs resources we seek serve our national goals and values -- and commitments to allies and friends.

National Security

As we have seen, the unwavering commitment of our allies to America's security -- and ours to their own -- is essential if we are to maintain the defensive framework which protects us all. Many of our friends in the developing world lack the resources to see to their national security while at the same time struggling to provide for the basic economic needs of their own people. Because we know that they must do both if they are to survive and grow, we give these nations economic support and help them finance the modernization of their armed forces. We also provide defense and economic support to some of our NATO allies to help them to modernize their military forces.

For FY 1989, our total request for discretionary security assistance funding (MAP, FMS, ESF, IMET, antiterrorism assistance and peacekeeping operations) is $8.3 billion. That compares with $8.0 billion in FY 1988 and $8.7 billion in FY 1987. In percentage terms, the increase is about 3 percent.

Despite this increase what we are seeking for security assistance is well below the level appropriated in FY 1987. The percentage cuts from the levels appropriated in FY 1985 and 1986 are even more severe.

For the two major military assistance accounts -- Foreign Military Sales (FMS) and Military Assistance (MAP) -- we are requesting respectively $4.5 billion and $467 million. By providing the assistance in the form of forgiven FMS credits, countries capable of doing so will be able to apply FMS funding to commercial purchases. This all-grant program initiative is consistent with a trend which began in the Congress a few years ago.

Our present efforts to reinvigorate the Arab-Israeli peace process underscore the critical importance of the Middle East to the United States. Israel and Egypt, two key partners in the Middle East process, will receive the largest component of our security assistance in FY 1989 ($5.1 billion), just as they have for the past several years.

In the West Bank and Gaza, our foreign assistance funding is direct evidence of our determination to help produce a better quality of life for the people of the occupied territories. Of the $12.5 million in ESF we seek for Middle East regional programs, $7.5 million would be channelled through private voluntary organizations in the West Bank and Gaza. And, of our $18 million ESF request for Jordan, $6 million is for activities in the West Bank. In addition, the U.N. Relief and Works Agency provides $90 million in assistance to Palestinian refugess in the territories, one-third of which would come from the U.S. contribution to that organization.

In addition to the funds for Israel, Egypt and the occupied territories, we are also requesting an additional $261 million in assistance for close friends such as Tunisia, Jordan, Oman and Morocco, thereby furthering the prospects for stability and growth in the region as a whole.

Security assistance is also used to strengthen the defenses of friends and allies which provide us with access to military facilities in the interests of their own security and ours. During the past few years, and particularly in FY 1988, cuts in our budget requests and extensive earmarking have limited our support to these countries. For Portugal, our assistance is well below the "best efforts" commitment we undertook when we signed the current base agreement. Assistance to Turkey is already hundreds of millions of dollars below the level necessary if our Turkish allies are to meet their NATO commitments.

Our assistance to Greece has fallen one-third below the level provided following the signing of our 1983 base agreement.

Our FY 1989 budget request is inadequate to make up for past shortfalls. We must begin to reverse the downward trend. Therefore, for these three countries we are requesting $1.1 billion in FY 1989.

In the Philippines, our assistance program has been directed toward helping a struggling ally revitalize democracy, beat back a Communist insurgency and promote economic growth. Despite budget stringencies, we cannot lose sight of the important mutual security interests at stake in the Philippines and the need for substantial support. I would note that we will shortly undertake with the Philippine Government the five-year bilateral review of our bases agreement. We look forward to its successful completion, which would set the stage for an extension or renegotiation of the bases agreement, the fixed term of which ends in 1991.

Central America is of vital importance to the United States because of its geographic proximity and strategic position. We have long recognized that the best way to protect our interests in the region is to promote regional security, democratization and development. We are requesting approximately $900 million in FY 1989 to serve these ends.

Concerning Nicaragua in particular, the Administration continues to seek funding from Congress for the Democratic Resistance. With the latest Sandinista offensive it appears that current efforts to secure peace and substantially ease the repression in Nicaragua may fail without a new package of assistance to the Democratic Resistance. Our provision of security assistance to the other countries in the region will serve as the only remaining bulwark against spreading instability.

Promoting Prosperity and Development

In today's increasingly interdependent world, a growing world economy is good for the U.S. economy, and, at the same time, a strong and competitive U.S. economy contributes to global economic growth. American growth and prosperity are, more than ever, influenced by conditions abroad. When we assist other countries to develop their own economies, we also develop a growing demand in the global economy for U.S. goods and services.

The current economic stagnation in a large number of developing countries, especially those with heavy debt burdens, illustrates the point vividly and painfully. For example, between 1981 and 1986 the countries of Latin America and the Caribbean experienced sharp declines in their real incomes. In the same period, our exports to that region dropped by over $11 billion. In contrast, our significant role in the development of Pakistan has paid us dividends.

In 1960, Pakistan's per capita income was barely $100. By 1985, Pakistan had more than doubled its income and had become a major purchaser of U.S. products. Since 1979, U.S. exports to Pakistan have risen by more than half.

We are requesting appropriations of $6.1 billion for economic assistance programs. Of that amount, $3.3 billion is for the Economic Support Fund (ESF), a program that supports economic stability and development as well as serves our security objectives.

In addition to ESF, economic assistance takes many forms:

- Development assistance ($1.6 billion, including the new Development Fund for Africa) to fund projects administered by the Agency for International Development (AID) in such areas as agriculture, education and human resources development, health, nutrition and private sector development.

- Funding for the Multilateral Development Banks ($1.3 billion). Seventy million dollars will go to the World Bank as the first installment of our contribution to the new General Capital Increase. The GCI will provide lending for middle-income LDCs undergoing economic reform, and is a top priority item. $958 million, will be used for the International Development Association (IDA), the "soft" loan window of the World Bank which finances development activities in the poorest developing countries.

None of these funds will be used to pay U.S arrears (currently about $400 million) to any of the development banks, due to lack of headroom in the 150 account under the Budget Summit agreement. We will seek arrearages in FY 1990.

- Funding for Peace Corps programs ($150 million).

- Voluntary contributions to such international organizations as the U.N. Development Program ($112 million) and UNICEF ($32 million).

Our domestic prosperity is also furthered by helping U.S. exporters compete with financing arrangements offered by foreign governments. For this purpose, we are requesting $705 million for the Export-Import Bank's direct credit programs. EXIM financing is also critical in markets in which commercial financing is limited or unavailable.

Promoting Democratic and Humanitarian Values

The United States has a vital stake in promoting democratic values around the world. Democratic institution building is a slow and difficult process. Fragile new democracies face challenges that we must help them meet with more than mere words of encouragement.

In Central America and the Caribbean, democratic institutions are taking root in countries where just a few years ago many despaired of that ever happening. These new democracies desperately need our help. The President's Caribbean Basin Initiative and the National Bipartisan Commission on Central America have provided comprehensive strategies for advancing the important process of democratic institution building in this hemisphere. The implementation of these strategies has met with strong bipartisan support and has involved a constructive joint effort by Congress and the Administration. For FY 1989, we are requesting $736 million in economic assistance for Central America, $217 million for the Caribbean and $160 million for the Andes.

The United States is never more true to its most cherished values than when we defend human rights and humanitarian values abroad. In our turbulent and often cruel world, the defense of human rights means more than just speaking up, although speaking up in itself is important. We must also provide funds to help the refugees fleeing oppression and the populations devastated by want and disaster.

Over the past few years, the assistance we have provided has meant the difference between life and death for literally millions of Africans who faced the worst drought and famine the continent has experienced in this century.

During the crisis, the United States provided 2.2 million metric tons of food aid at a cost of over $1 billion; another $150 million was spent to provide medicines, shelter, wells, and the other immediate needs for those worst affected by the drought. This was all in addition to the regular economic assistance we provided during the same period.

Similarly, we assisted Colombia at the time of its volcanic disaster, we contributed to major earthquake relief efforts in San Salvador and Mexico City, and we helped to combat locust infestations in 17 African countries. Our support for the World Health Organization and UNICEF has helped rid the world of some of the most deadly and contagious diseases and has dramatically reduced infant mortality.

We can be proud of America's record of assistance to the world refugee population. Since the passage of the Refugee Act of 1980, the American people have offered new homes to more than half a million refugees -- a greater number than has been provided by all other resettlement countries combined.

For FY 1989, we are requesting $340 million for Migration and Refugee Assistance, about the same as the FY 1988 appropriation. Of that total, we plan to allocate $217 million for relief assistance for refugees in first asylum camps around the world through such agencies as the U.N. High Commission for Refugees, the International Committee of the Red Cross and the U.N. Relief and Works Agency as well as a wide range of private voluntary organizations.

An additional $115 million will be available for refugee admissions to the United States for a minimum of 68,500 refugees -- the same number as in FY 1988. Since we will have fewer dollars than we do this year to admit at least the same number of people, we will have to reduce the services we provide to these refugees. Otherwise, we would have to cut down on admissions just when the pressure of admissions is growing -- with the likely increases in refugees from Vietnam, the Soviet Union, Cuba and perhaps other countries as well.

Combatting International Narcotics Trafficking and Terrorism

International narcotics trafficking and terrorism are the twin barbarities of our modern age and they pose a particular threat to open, democratic societies. The Administration, Congress and, above all, the American people agree that we must combat them with all responsible means at our disposal.

As we have seen graphically in Colombia, and most recently in Panama, international narcotics trafficking poses a threat not only to the health and welfare of our citizens, but to the national security of free governments throughout the world. And the threat continues to grow.

For FY 1989 we are requesting $101 million for international narcotics control, a 2 percent increase over the amount appropriated in the continuing resolution for FY 88. This includes $32.6 million in direct assistance to Colombia, Bolivia, Peru, Ecuador and Venezuela.

It includes $18 million in support for aerial and manual eradication of coca plants and for transporting paramilitary and police units on raids against cocaine labs. And, it includes funding to help assure concrete follow-up on the recent International Conference on Drug Abuse and Illicit Trafficking.

These programs constitute only a part of our total effort to control international trafficking in narcotics. Economic and military assistance is also important in this effort. Such assistance supports public awareness programs, projects which develop viable income alternatives to farmers who depend on cultivation of narcotics crops for their livelihood, increases in the capability of military forces to contribute to eradication and interdiction efforts, and encourages macroeconomic policy changes which produce overall growth and income.

International terrorism, like international narcotics trafficking, offends the most cherished humanitarian values of democratic societies and poses a serious threat to international stability. To combat it, we must be vigilant and we must be prepared to commit the needed resources.

Through long and often bitter experience, we have developed an effective policy to deal with this scourge. We have developed a better understanding of terrorist methods. We are working closely with other countries, in part by pooling intelligence resources.

Through U.S. leadership at the International Maritime Organization and the International Civil Aviation Organization, we recently have achieved international agreement on means to combat terrorism on the seas and in the skies. We are also working to persuade countries reluctant to cooperate in combatting international terrorism to rethink their positions. We are providing training and training-related equipment to those with the will but not the means to cooperate. We have strengthened security measures to protect our citizens at home and abroad. And, we have gone on the offensive to bring terrorists to justice, disrupt their operations and destroy their networks.

U.S. programs to enhance the counterterrorism skills of other nations consist of training and provision of equipment and logistical support. For FY 1989 we are requesting $9.8 million to continue the Department of State's Antiterrorism Assistance Program. With the requested funds we will be able to train some 2,000 security officers from around the world in a variety of antiterrorism skills.

Our Essential Foreign Policy Instruments

The funds Congress provides to the Department of State, the U.S. Information Agency (USIA), the Board for International Broadcasting and for our assessed contributions to international organizations are essential to the effective execution of our global policies.

The Department of State is our key foreign policy instrument. At the Department, our only resource is people. If we are to effectively pursue America's interests in the world, we must maintain a strong, professional, well-trained diplomatic service. And, the Department cannot vigorously advance our nation's most vital goals and objectives if it is weakened by insufficient funds and strapped by earmarks.

As a result of the falling value of the dollar and high inflation overseas, the resources of this Department are stretched thin. And the infrastructure needed to support our worldwide operations is threatened. To meet the minimum needs of the Department of State operational requirements, we are requesting $2.1 billion. Having to work with less would lessen our understanding of developments abroad, our influence over those developments, and our ability to gain international support for policies that serve our interests.

This budget includes provision for the construction of an up-to-date national Foreign Affairs Training Center that encompasses the latest classroom and technical teaching aids for adult learning. The ability of U.S. Government employees to serve us well abroad is directly dependent on the quality of instruction they receive in language, area and professional studies, as well as the security training mandated by Congress.

The work of Radio Free Europe/Radio Liberty and the United States Information Agency's Voice of America (VOA) are essential and effective instruments for promoting democratic values and ideas around the globe. We are seeking $816 million for the USIA's operating and special program accounts compared to $820 million in 1988 -- a net cut of $4.5 million. And we are seeking a capital budget of $65 million for the Radio Construction appropriation to continue VOA's modernization on a sharply focussed basis. No funds were appropriated for this purpose in FY 1988. Our modest request reflects the need for a lean budget and will entail program reductions throughout USIA. It does not begin to measure the tremendous positive impact USIA's programs and VOA broadcasts have throughout the world.

For the Board for International Broadcasting (BIB), we are requestng $192 million for the basic portion of the budget and $35 million for the next installment on the new Israeli transmitter project.

Active U.S. participation in the United Nations and other international organizations is a key component of our worldwide efforts to promote peace, well-being and freedom. In recent years, we have sought to use our influence -- much of it financial -- to make the United Nations more efficient and effective. We are beginning to see results.

The work of the Security Council to end the hostilities in the Persian Gulf and our successful efforts last week to get international human rights observers into Cuba show just how valuable the United Nations can be. The U.N.'s Specialized and Technical Agencies provide direct benefit to the United States, as reflected in th World Health Organization's campaign against AIDS, the International Atomic Energy Agency's work on nuclear safeguards and safety, and the International Labor Organization's promotion of human rights and better working conditions. To ensure that the reform process throughout the U.N. system continue, we must provide U.S. support. And, we intend to counter the USSR initiative to restructure the U.N. to meet Soviet policy objectives.

We have requested $490 million to fund our assessed contributions to 46 international organizations, $29 million for international peacekeeping activities and $6 million for international conferences and contingencies. Reflecting the constraints of the Budget Summit compromise our requests are well short of requirements. This adds to the necessity for full appropriation of the requests.

The Need for Resource Flexibility

To meet all of these major foreign policy objectives that I have described, we will need more than your support for our total funding request, which is already at the bare-bones level.

We will also need legislation that gives the executive branch the latitude we need to manage the very limited resources we have effectively.

The Continuing Resolution for FY 1988 does not give us that flexibility. In the security assistance area, almost 95 percent of the total appropriation has been earmarked for particular countries or programs. In many instances, Congressional earmarks are consistent with the levels we recommended and represent a congruence of views between the Administration and the Congress regarding the priority of particular programs.

But the overall effect of massive earmarking in the context of sharp cuts across the board is to place the burden of those cuts disproportionately on programs which must be funded from the 5 percent of the budget which is not earmarked. We have been forced to cut drastically ESF, MAP and/or FMS programs to such staunch friends as Turkey, Portugal, El Salvador, Honduras, Jordan, Kenya, Somalia and Zaire. Moreover, we have been forced to eliminate entirely programs in a whole host of other countries in the Caribbean and Africa, and particularly in South America -- where struggling democracies are confronting deadly threats from terrorists and drug traffickers. As a result of earmarks, we were also compelled to reduce assistance to refugees in every area of the world.

If we are given the needed flexibility, the levels of funds in the budget request for FY 1989 will enable us to reconstitute on a modest scale many programs we had to curtail or cut off this year.

Conclusion

To accomplish our national goals and further our interests abroad, the Reagan Administration -- and its successor -- will need to demonstrate clarity of purpose, staying power and bipartisan support. As my brief discussion this morning of our approach to key foreign policy issues was meant to show, we have a clear idea of where we're going and we are determined to get there. But the other two essentials of foreign policy success -- staying power and bipartisan support -- are critical ingredients that greatly depend on you here in Congress.

In closing, I would like to draw your attention to the American eagle on the seal of the United States. I am fond of pointing out that our internationally recognized symbol is clutching an olive branch in one set of talons and a bunch of arrows in the other. The eagle's head is turned in the direction of the olive branch. Our far-flying eagle is grasping both olive branch and arrows because America must commit military strength to the service of peace if we are to remain true to our values and advance our interests abroad.

Today, I have described the particulars of an austere foreign operations budget for FY-89. During the next fiscal year, two successive Administrations will shoulder the burden of America's global responsibilities. Both will face the challenge of fulfilling our national objectives in a complex and changing world. To meet this challenge, both Administrations will need not only the full amount of requested funds, but also the latitude to apply them effectively.

The message I want to leave with the Committee today is this: we must not allow the American eagle to become so undernourished or so encumbered in her flight that she looses her grip on either the arrows or the olive branch. Neither this Administration nor the next one can afford to let that happen. Far too much is riding on her wings.

Chairman Chiles. Let me just start off and ask you if you will bring us up to date. We understand that troops were introduced to Honduras last night. I wonder if you could tell us the circumstances surrounding that, whether a request was made, what was the nature of the request. What can you tell us about the mission of the troops, what their purpose is, and what are the facts on the ground in Honduras as we find them today? And what, if anything, has been the statements or requests from the neighboring countries also surrounding in that area?

Secretary Shultz. Thank you, Mr. Chairman.

Well, first of all, what was the President's decision? Last night, the President decided to send two battalions from the 82nd Airborne Division and two battalions from the 7th Infantry—the Airborne Division is located in Fort Bragg, NC; the Infantry Division at Fort Ord, CA. Altogether this involves about 3,200 men. All of the forces involved are light infantry; that is, there is no artillery. The deployment, we expect, will be essentially complete by midnight on Thursday—that is today, isn't it?—all deploying to the Palmerola Air Base. That is about 125 miles away from the area of fighting, and it is near Tegucigalpa.

The troops will take part in exercises that are something that is ongoing, but they are sent in response to a Nicaraguan troop movement into Honduras and in response to, most particularly, a request from the President of Honduras.

So that is what the President did. Let me just now review sort of chronologically what took place, and then state some of the views of leaders around the region.

Chronologically, what we have observed and seen is that, beginning around March 1 and carrying on for about a week-and-a-half, we observed what seemed to be Sandinista preparations for an offensive. They were moving supplies, vehicles, heavy equipment into the Bocay Valley. We were obviously aware of this, as were the freedom fighters and the Hondurans. We could see that a command and control center was being established in Bonanza, a town in Nicaragua about 45 miles southeast of the Bocay Valley.

On March 8, Mr. Ortega announced "a heroic drive" against the resistance. On March 9, the Sandinistas deployed some 360 troops into the Bocay Valley in 18 helicopter sorties. There are scarce petroleum reserves; that is, they do not have a lot of petroleum reserves in Nicaragua. But they released these petroleum reserves for operations, and we could see that there were tight communications security laid on.

On March 10, there were contacts between the Sandinistas and the freedom fighter patrols inside Nicaragua. As they patrolled, they could feel each other's presence.

On March 15, we had reports from the freedom fighters of heavy fighting, some Sandinista troops inside Honduras. We had reports of continuous bombing of Honduran territory by Nicaraguan AN-26 aircraft. Two airfields, resistance airfields that are located on the border area were seized.

President Azcona was alarmed by this, of course, and he called Presidents Duarte and Cerezo and also Ortega to tell them to withdraw Nicaraguan troops from Honduras or face the consequences.

On March 16, the reports that we had—and all intelligence reports, of course, of this kind, are not precise. We cannot swear by a given number—but the range of the estimates seemed to be pretty consistent—was that we saw a presence inside Honduras of somewhere in the neighborhood of 1,500 to perhaps as high as 2,000 Sandinista troops. This posed a critical situation for the resistance because they were basically outmanned and, of course, outgunned, as there were not only the AN-26 aircraft but also the heavily armed helicopters being used to support the Sandinista troops.

At 11 a.m. on March 16, the Honduran Foreign Ministry issued a statement about fighting on the border. President Azcona told our ambassador, Ambassador Briggs, as he had heard people say that there was no such movement into Honduran territory, he said that was absurd.

At 3 o'clock in the afternoon, Ortega made a radio address in Nicaragua and denied that Nicaraguan troops had crossed the Honduran border. I might say that the Speaker informed us yesterday that he was called by the Foreign Minister of Nicaragua, who told him that the troops were withdrawing.

You never know who to believe.

Chairman CHILES. Even if they were not there, they are withdrawing now.

Secretary SHULTZ. You got it.

At 4:45 the Honduran Super mystéres conducted a reconnaissance of the Bocay area. At about 5:15 in the afternoon, Ambassador Briggs met with President Azcona, General Regalado and Foreign Minister Lopez. President Azcona gave to Ambassador Briggs a letter requesting United States assistance and instructed Foreign Minister Lopez to send a stiff protest to the Sandinistas.

We had, of course, been following this situation closely and had brought Members of the Congress up to date in various meetings as best we could. I would have to say that no matter what you describe, people shake their heads and say, "I do not believe you," "This isn't so," "We have other reports," and so on. Nevertheless, we tried to describe the situation as accurately as we could as we went along.

We have had meetings with the President. Our so-called Policy Review Group of senior people met at the White House yesterday in the late afternoon. About 6:45 Ambassador Briggs called in to report the results of his meetings with the President of Honduras and associates. And we had various other reports from people in the region. In the light of President Azcona's request and developments in the region of the clear statements and the Rio Pact and various UN and OAS charters, the President responded to President Azcona's request; and the response was the action, or one of the responses was the action that I outlined to you.

Now, these troops are there. They are lightly armed. They will take part in an exercise. They are not near where the fighting is taking place. But they are designed to say to the Government of Honduras that we are your friend and we stand with you; and if you are invaded, you can count on the United States. And it also tends to get people's attention to something that is happening in the Central American region that we feel is wrong.

Now, we are not the only people who feel that it is wrong, and I will not try to go through what everybody has said. But I have two things I would like to read out to you.

One is a communique issued by the Foreign Ministry of Honduras giving their view of the situation, and the other is a statement by President Arias of Costa Rica. First, I will read the Honduran statement. This is a translated text of what they issued:

> The Honduran Foreign Ministry informs the national and international public about the incidents that have occurred at the border between Honduras and Nicaragua in the Bocay area in the Olancho Department. On 15 March the Honduran armed forces informed the President of the Republic about the violation of the national territory by EPS forces.

That is the Nicaraguan forces—

> Several hundred EPS forces entered Honduran territory supported by artillery and airplane and helicopter bombing. In an effort to prevent a deterioration of the border situation, the President contacted President Ortega, demanding that he order his troops to refrain from violating Honduran national territory and withdraw the military units that have invaded Honduras. The President also contacted Jose Napoleon Duarte, Vinicio Cerezo and Oscar Arias Sanchez to ask them to demand that the Nicaraguan Government stop its aggression against Honduras and withdraw its troops from the border region.
>
> On the same day, 15 March, after making these telephone calls in an effort to safeguard the security of Honduras, President Azcona addressed a letter to the U.S. President informing him of these incidents and asking him for his solidarity to reject the violation of Honduran territory. In view of the fact that the military action in Honduran territory by the EPS is an act of aggression, President Azcona, based on a special relationship of security existing between the United States and Honduras, and based on the international mechanisms for collective security, felt compelled to ask the U.S. Government for the effective and immediate assistance needed to preserve the country's sovereignty and territorial integrity.
>
> On 16 March, the U.S. Ambassador in Tegucigalpa, carrying out specific instructions from his government, reaffirmed his country's commitment to support Honduras and to supply all the aid that our country may need to defend national sovereignty. The Foreign Ministry presented to the Nicaraguan Government its most vigorous protest over the aggression that was carried out, demanding the immediate withdrawal of the invading troops and warning the Nicaraguan Government that it would adopt the necessary measures to exercise its right to legitimate defense established in Article 51 of the UN Charter. Honduras deplores the Nicaraguan Government's insistence on jeopardizing the effort to resolve its social conflict through the use of international violence for the incidents that occurred on the border.
>
> Tonight, the President of the Republic again talked with the Nicaraguan Government, an occasion he used to reiterate the urgency of withdrawing the Sandinista troops from Honduran territory and to inform him about the measures that the Honduran Government has implemented to safeguard its sovereignty and territorial integrity.

That is a press release of the Honduran Foreign Ministry.

This is a statement made by President Arias yesterday, last night, I guess:

> This is an arrogant attitude, regardless of whose it is, to try to bring the other party to the negotiating table on their knees to obtain a greater advantage in negotiations. For me I am convinced that negotiation and dialogue are the best solution, and that at the negotiating table both sides have to compromise to reach a ceasefire. I cannot view favorably the kind of action which is being carried out, which removes us further from the possibility of dialogue. It puts in danger the plans for the meeting of March 21–23, which was already confirmed. It puts it in danger because I no longer know what is going to happen, whether it will take place or not.
>
> I just had the opportunity to say this personally to Daniel Ortega. I also had the chance to speak with Cerezo this morning. I told them my concern. Later I spoke with President Azcona and

I think this is the thing to focus on—

> If it is confirmed that Honduran territory and the sovereignty of the Honduran people have been violated by Sandinista forces, and all of our intelligence is that that is so, then Costa Rica must necessarily condemn this act categorically and vigorously. Costa Rica believes that in the respect for international law and national sovereignty lies the security of every nation in the world. Therefore, if Honduran territory has really been invaded by Sandinista forces, I condemn it. This is not the moment for a military strike to finish off the enemy.

That is the quote from President Arias.

So it is a serious situation, and it is not the first time that Nicaragua has sent troops into Honduras. We have always reacted, as has the Government of Honduras reacted strongly to such troop movements. In this case, it is particularly highlighted by the fact that there is supposed to be a peace process going on. Back last August, all of the parties signed up to the Esquipulas agreement that had, at least as its stated objective, the bringing about of democratic patterns of government in all of the countries, and called for negotiated cease-fires and movements in the direction of peace. That was confirmed and elaborated, and the Nicaraguan lack of compliance was highlighted by the other four presidents in the meeting in San Jose in January.

So gradually, we have seen an effort to put together cease-fire talks, and they have gone on and off. The Government of Nicaragua has not chosen to do it until recently, although the Resistance has been ready for a long time. And so at least there has been an effort to construct an environment moving toward peace. I think the putting of troops into Honduras by Nicaragua under those circumstances, as you can see, has shocked President Arias as it has many other people, including us.

So that is basically the situation, and I think it is a very serious one. Obviously, the vote in our House of Representatives to deny further assistance to the freedom fighters has dealt them and, in my opinion, the cause of freedom a very serious blow. Nevertheless, we have to struggle with what we have and not in any way give up on the importance of security and prosperity and the rule of law and democracy in our area and throughout Central America.

Chairman CHILES. Senator Domenici.

Senator DOMENICI. Mr. Secretary, could you elaborate just a little bit more on what the impact, in your opinion, is of the Nicaraguan decision? It seems to me their decision is to try to finish off the contras. What impact has that had on the other democratic Central American countries? And while you have talked about what is one of the President's things about its impact on the peace talks next week, what do you think this means as far as the peace talks scheduled for next week between the Resistance and the Sandinistas?

Secretary SHULTZ. Well, I hope that they will go forward. But at the same time, it is important that the freedom fighters not agree to something that amounts to surrender. The positions they have taken in those talks about a cease-fire creates an environment.

Senator DOMENICI. For what?

Secretary SHULTZ. For political discussion and negotiation. A cease-fire just by itself is not the object. The object is to have the kind of negotiations that will make the undertakings in the Esquipulas meeting come into being.

Now, I think we should recognize that the Sandinista proposals of the cease-fire talks amount to a proposal for a kind of unconditional surrender, which no one should want. Certainly, we do not want it, and I know the freedom fighters do not want it. So if you see them resist that, well, they ought to resist that.

But, at any rate, if cease-fire talks go forward and get a respectable, worthwhile outcome, that is all to the good. It is very difficult not to place a cynical interpretation on the behavior of the Nicaraguan Government. I resist it somewhat myself. I would like to see things get better and move in a peaceful direction. But it is clear enough that at Esquipulas they signed up to a program of government behavior that is not their natural way.

Why did they do that? Well, it is hard to avoid the feeling that they did it because, on the one hand, around them they saw a more democratic and popular environment. At the same time, their own economy and society is an absolute mess. It is not surprising that a Marxist form of running an economy fails. It fails everywhere so it is not surprising it fails in Nicaragua. But it is failing. And, most importantly, they found a force of freedom fighters of Nicaraguans who were pushing for freedom and independence in their country and giving a very good account of themselves, having gotten a reasonable amount of U.S. support.

So under those circumstances, they signed up to something. But when the time came to say what have they done, it was also apparent that they had not done very much. They had done some things. So we welcomed the things they did. But they were not adequate.

It is also quite apparent that after the House vote, all sorts of negative things started happening. They started once again when opposition groups held rallies to put down the rally. Having invited Cardinal Obando y Bravo to be the mediator in cease-fire talks, they decided they could do without his services and maybe he could be an observer. Then we have this. So we cannot help but believe that most of this has been quite probably an effort to so construct a political situation that would allow them to destroy the freedom fighters, who at this time receive no material support from anybody.

Senator DOMENICI. Mr. Secretary, this is my last question. I understand everyone is here because they want to inquire.

Mr. Secretary, what is different about this incursion across the border than previous ones? We are now hearing from those who are challenging, if not directly at least impliedly, the decision of the President of the United States. And some are saying that the Sandinistas have crossed the border before. What ingredients are different in this situation than heretofore?

Secretary SHULTZ. They have crossed the border before, and we have reacted before, too. I forget exactly when the last time was. It was about a year or so ago. At that time, the Honduran Government requested help from us in the form of helicopter lift capacity to take their forces closer to the scene of the action in an effort to repel the Sandinista forces. And we responded to that and we did that.

So, in one sense, the movement of armed forces from Nicaragua into Honduras, it has happened before and it is happening again. It is not different. It is the same objectionable thing.

Now, in this case, however, you have the added dimension that the environment that presumably was intended to be created by the Esquipulas accords and the follow-on San Jose meeting and all of that was supposed to be a movement in a different direction. So I think probably that adds a dimension here that was not present before.

Chairman CHILES. Senator Sasser.

Senator SASSER. Thank you, Mr. Chairman.

Mr. Secretary, I agree with some of the statements you made earlier about the drug problem and the great threat that it poses to our country and, indeed, all of our hemisphere. And I suspect that when the history of the latter part of the 20th century is written that the problem of drugs are going to get a lot more ink than the sideshow that is taking place now in Central America, which I think will probably be a small footnote in history.

You indicated, Mr. Secretary, that the President of Honduras requested that U.S. troops come into that country. During the time that our intelligence people were detecting the movement of Sandinista forces up to the border of Honduras and perhaps across them, has there been any movement of Honduran troops into that area to try to defend their own territory and to repel the incursion of Sandinista forces?

Secretary SHULTZ. The area is a rather remote one, and we have watched these preparations and the Hondurans have watched the preparations; but they have not taken any direct action.

Senator SASSER. Mr. Secretary, we are sending four battalions of troops, two from the 82nd Airborne and I think two from the 7th Infantry Division, to Palmerola, a U.S. military installation that we lease from the Honduran Government that is about 125 miles, if memory serves me correctly, from the border with Nicaragua. Are there any intentions on the part of the administration to move these troops closer to the Nicaraguan border as they engage in military exercises? Or do we intend to keep them relatively far away from the action; that is, at the Palmerola Air Base?

Secretary SHULTZ. The exercises are, I believe, in that vicinity, but that is a question that people from the Pentagon would be better able to answer. But the troops are not there to then be sent into the area of the fighting. There is no plan for that at the moment.

Senator SASSER. Well, I share your disappointment and frustration that this incursion of Sandinista troops did take place into Honduras. I think we would probably both agree that this was a very stupid move on the part of the Sandinista Government, also a very provocative move, and that this attack by the Sandinistas clearly violates the spirit of the Arias peace plan, and President Arias has denounced it.

But I think most disinterested observers would also say that the existence of the contra camps themselves in Honduras also violates the Arias peace plan. They were supposed to have been disbanded by the Government of Honduras under the provisions of the Arias peace plan, and they have not been disbanded.

Secretary SHULTZ. That is not correct, Senator. In the peace plan that was agreed to in Esquipulas, there is a very important word—"simultaneous"—and it calls for a variety of things to happen with simultaneity. And in the San Jose communique, the statement that was issued in January, it is clear that what was conceived, at least by the four democratically elected presidents, was the notion that you would expect to see the negotiated cease-fire; you would expect to see amnesty; you would expect to see a variety of other things that were set out in the Esquipulas accord as being attributes of a different political environment take place. And that would be followed by a change in the status of the freedom fighters.

Obviously, if you had a negotiated cease-fire and that kind of negotiation, you would have created a different environment. It has not happened.

Senator **SASSER**. Well, I think, Mr. Secretary, that what is occurring here—and I suspect we do not have any disagreement about this. I think what is occurring now in Central America is a grim reminder that perhaps the best hope for this region is to adhere to the Arias peace plan.

Secretary **SHULTZ**. I agree with that.

Senator **SASSER**. We see now the movement of Nicaraguan troops, another Nicaraguan incursion into Honduras. We see now the movement of substantial U.S. military forces into Honduras. And we see the Sandinista Government, according to the information that I am receiving, reacting to the movement of our forces into Honduras by closing down the opposition radio stations in Nicaragua, which from all accounts had done a pretty good job of spreading the word in opposition to the Sandinista Government. And the Sandinistas are using this as an excuse now, as I understand it, for full mobilization, calling up the troops and rallying the population, saying we are expecting an invasion from the United States.

It is an unhappy situation, and I would hope that at some point in the not too distant future the leaders of the Central American countries would once again fall back and support this Arias peace plan, both in the spirit of the peace plan and to the letter of it.

Secretary **SHULTZ**. Senator, I agree that we would all be better off if everyone went along with the Esquipulas accord, and the principal culprit in that regard is the Government of Nicaragua.

I just would like to make one remark on your comment about the closing of radio stations, and that is to say that the Nicaraguan Government was harassing the opposition long before today. That has been a constant, especially since the House vote, and they look for any excuse to shut down the ability of opposition to speak, to hold rallies, to express themselves.

Senator **SASSER**. My time has expired. Thank you, Mr. Secretary.

Chairman **CHILES**. Mr. Secretary, just another note of the auspiciousness of your appearance here today. We are flattered in the Budget Committee to have Senator Thurmond join us, former President Pro Tem of the Senate and distinguished chairman of the Judiciary Committee. I know it is St. Patrick's Day, and that perhaps has something to do with the auspiciousness of the occasion. But I note that he is sitting on the right side now, and perhaps it is like the Prodigal Son that he is returning to the fold. If so, we want to kill the fatted calf and put the ring on him. We are flattered and just delighted to have him here to join us today.

Senator **THURMOND**. Thank you, Mr. Chairman, for inviting me. This was the most convenient seat I saw when I walked in.

Secretary SHULTZ. Senator, just so you feel at home on St. Patrick's Day, I will put my handkerchief out here to go with the tablecloth.

Chairman CHILES. Senator Nickles.

Senator NICKLES. Mr. Chairman, thank you very much.

Mr. Secretary, I have read a little bit this morning, but I have not heard your statement about the fate of the contras. I have read where possible munitions depots were overrun, that the contras were in disarray, disbanding, disillusioned.

What is the fate of the contras? Will they survive this latest assault?

Secretary SHULTZ. They are tough people, and they believe in what they are fighting for. So I am sure in one way or another they will survive. They deserve our support. They are not getting it. So that disillusions them.

Exactly what the situation on the ground is this very moment, I cannot say because it is a relatively fluid situation. And our objections and the objections of others to the fact that Nicaragua has gone into Honduras may cause them to get out. But probably they do not want to get out until they have done as much damage to the freedom fighters as possible. We will see about that, but we would like to see them move out.

Senator NICKLES. Have the Sandinistas been successful in destroying a large percentage of the contras' munitions supplies?

Secretary SHULTZ. Probably that is one of their objectives, and at least as of the last information I have, they had not succeeded in doing that.

Senator NICKLES. Is the administration planning on making a renewed request to Congress for military and nonmilitary assistance for the democratic resistance?

Secretary SHULTZ. The President has not made any decision on exactly what to request. But, clearly, the freedom fighters deserve support, in my opinion and in the President's opinion. Furthermore, I think that they need support without restrictions on it so that they can buy the things that they need.

Now, I think it is also the case that a pattern of support that sort of gives you a little money for a month or so, and then another vote and a little more money for a month or so and so on, that is not really—obviously, you would rather have that than nothing, but it is not a good kind of support. You need to have something where you can count on it to go for a period of time and not be cut off.

So I cannot say exactly what the President may request, because at least as of yesterday he had not made any decision about that. But, first of all, it would seem to me, we should step back a little bit from exactly what should be requested to focus on the problem. What is the problem? Is there a problem? What is its nature? What is its effect on the United States?

And I think we have a problem on our hands that is a threat to the national security interests of the United States, and it is a threat to all of the basically good things that have been constructed with strong bipartisan support as it has unfolded in Central America generally. And I recall when we had the supplemental—I know that word has been banned from the conversation here, but back in the good ol' days, the last supplemental we had, with a lot of help from Senator Kasten, had, as I remember it, $300 million for the Central American democracies in it. So it showed the breadth of support, and that is all threatened.

Senator **Nickles**. Mr. Secretary, I would urge you to move as rapidly as possible. I am concerned if we move too slow that the fate of the contras is in jeopardy.

I think that the vote by the House of Representatives in defeating contra support was a real psychological blow, and contributed to the events that have happened just these last couple of days.

Do you think the Sandinistas have a goal for their participation in the negotiations to reduce the support for the contras in Congress—that has been somewhat successful? Then as a result, trying to move to eliminate the contras as an opposition force, while the contras find themselves in a weakened position.

Secretary **Shultz**. Yes, I do think that is their objective. And there are all sorts of reports of the fact that they had their eye very much on the vote in the House. And I am shocked to say that apparently they got advice from people here about how to do it.

Senator **Nickles**. I think from reading reports, they may still be receiving advice from the Speaker or other people as recently as yesterday, and that concerns some of us as well.

Thank you, Mr. Secretary.

Chairman **Chiles**. Senator Conrad.

Senator **Conrad**. Thank you, Mr. Chairman. First of all I just want to make a quick statement that the Sandinistas have engaged in what I would call an extraordinarily stupid move.

Some of us voted not to proceed with aid at this point based on a request from Oscar Arias that we refrain and are given every opportunity for success; no excuses for failure. And I see this as clearly a violation of at least the spirit of what was supposed to be going on.

But let me ask, Mr. Secretary, were we requested by the Honduran Government to specifically send troops?

Secretary **Shultz**. We were requested to help. And this is—and there are various things that we have been asked to do, some by way of provision of information. And this we decided was one thing that could be done properly and quickly, and would be a visible sign.

Senator **Conrad**. Am I to take from that that we were not specifically requested to send troops?

Secretary **Shultz**. We were requested to give help of this nature. And what just exactly was the request, I am not in the position to say.

Senator **Conrad**. I think you know the importance of the answer to that question. If we have sent troops, but were not specifically requested by the Government of Honduras to send troops, that is going to fuel the speculation that perhaps there were other agendas at work here.

Secretary **Shultz**. It is hard for somebody in another country to know precisely what to request. But let me read from the communique of the foreign ministry of Honduras. And while I am not in a position to release the letter that the President of Honduras wrote to the President of the United States, this is an accurate paraphrase of it.

And here he says: In view of the fact that military action in Honduran territory by the EPS—that is, the Nicaraguan armed forces—is an act of aggression, President Azcona, based on a special relationship of security existing between the United States and Honduras, and based on the international mechanisms for collective security, felt compelled to ask the U.S. Government for effective and immediate assistance needed to preserve the country's sovereignty and territorial integrity.

So that was a specific request. Now, we have to say, what can we do quickly? This is something that we could do that fitted into the exercises, that would catch everybody's attention, and they are very happy to see it.

Senator CONRAD. You know there is——

Secretary SHULTZ. But if you are asking me, did President Azcona say, would you please go to those people in Ft. Ord and get this particular battalion, I do not imagine that he has the knowledge of our forces and what could be done and how fast to make such a specific request.

Senator CONRAD. No; I am certainly not asking if he asked specifically to send troops from Ft. Ord. The question is, did he request troops be sent from the United States from whatever location?

Secretary SHULTZ. Well, I read out the nature of his——

Senator CONRAD. Obviously, that is a concern. We remember the advice that Secretary Weinberger provided on what we ought to do in terms of developing a set of principles for the commitment of U.S. military forces.

Two of the things that he set down as principles are, one, if we commit troops, we should do so wholeheartedly with the intent to win, and, number two, that we need clearly defined military objectives and understanding of how our forces will carry out those objectives.

What military objectives do we have in the commitment of troops to Honduras? Do we have clearly defined military objectives for the introduction of troops into Honduras?

Secretary SHULTZ. Our objective in sending these troops—and it is completely consistent with the request of President Azcona and welcomed by him—our objective is to make a visible sign of support for Honduras that everyone can see. And to do it in a manner that fits in with ongoing exercises, so there is a process that it can be a part of. And in so doing, reinforce the objection of President Azcona and others to this action by Nicaragua.

That is the objective.

Senator CONRAD. What is the military objective? Do they have a specific objective to take territory, defend territory, defend the sovereign borders of Honduras?

Secretary SHULTZ. No; they are not there in a so to speak shooting military capacity. They are lightly armed. They have gone to an area where we customarily are. And they increase our presence. And they do it in a visible way that gets people's attention.

And I must say, that has worked. It does get people's attention.

Chairman CHILES. I need to switch so everybody will get a chance.

Senator **Conrad**. Thank you, Mr. Secretary.

Chairman **Chiles**. Senator Kasten.

Senator **Kasten**. Mr. Secretary, I would like to follow up on a question that Senator Domenici asked before, about the nature of this latest Sandinista attack. At one point, you said that the key difference, or at least one important difference between this border crossing and those of the past, is that the peace process was supposed to be in place at the time of the attack.

If this is the case, then I want to know if there is a difference in the scale of this attack? Specifically, is there a significant difference in the level of bombing now compared to what we have seen in the past?

Another concern is the AN-26 aircraft. Is there a difference in the mobilization that we have seen taking place in Nicaragua with regard to the AN-26?

Finally, you touched on the fact that the Sandinistas were dipping into scarce petroleum reserves. Is there a difference between the number of troops, the type of troops or the kind of armaments used by the Sandinistas now compared to the past?

Secretary **Shultz**. I think, broadly speaking, the answer to your questions is yes. But I am not prepared to go down specifically and give you a number of troops in this case and in this case.

But as to the general scale, the answer is yes, it is larger. And the environment, the circumstances, as you suggested, are different.

At the same time, it's the same thing. It is an action on the part of Nicaragua, moving troops into Honduras. They have done that before. We have reacted before. And here they are, doing it again on a larger scale, and under different circumstances.

Senator **Kasten**. Since the House vote which defeated aid to the freedom fighters, have we seen an increased scale of Sandinista military activity?

Secondly, Mr. Secretary you mentioned that the opposition radios within Nicaragua have been shut down recently.

With respect to this, my question is: Have we seen an increase in the scale of activity against the opposition forces within Nicaragua?

Secretary **Shultz**. Yes; and we have seen that people in opposition in Nicaragua have rallies repressed. We have seen Cardinal Obando y Bravo, who they initially invited to be the mediator in ceasefire talks, dismissed, and now told that he can be an observer and not a mediator. So that means his ability to be forceful is much less.

So we see all these things. And it is almost impossible not to have the interpretation that they conducted themselves carefully to influence as much as they could the vote in the House, and then once they have gotten it, they have been moving in the directions they truly want to go to, perhaps being a little careful here and there so they don't produce another vote, but of a different answer.

But their object, at least it seems to me, their object is to get rid of the freedom fighters if they can. And they cannot do it. Because the freedom fighters have a core of support that is based on their own conviction.

But obviously, people who are fighting have limited capacity if they have no support. I think it is also worth taking note of the fact that the Soviet Union has, if anything, stepped up its support, military support, to the Government of Nicaragua, so far this year, as compared with comparable months last year.

So they are continuing to get major support from the Soviet Union.

Senator **Kasten**. Mr. Secretary, what is the situation on the ground right now as you understand it? Are the Sandinistas still attacking? Are they pulling back? What is the latest information we have about the Sandinista response to our activities of the last 12 hours?

Secretary **Shultz**. I hesitate a little bit, because it is a fluid situation. And I could say something here, based on the briefing I had earlier this morning, 7 o'clock this morning, that could be wrong.

But as a general proposition, they have moved in force into Honduras. And they have had fixed-wing and helicopter support for it.

The freedom fighter forces there are outmanned and outgunned.

Nevertheless, as of the best of our intelligence this morning, they still had maintained control of certain key places. But they are under great pressure, and their leadership is under great pressure.

So it is a threatening situation. Now, the Nicaraguans are conducting a campaign of trying to fool people, as I read out earlier in the hearing, in going through the chronology.

We have Ortega at 3:05 on March 16 on the radio denying that Nicaraguan troops had crossed the border. I think we all know that that border is marked by a river, which is about as wide as this hearing room, or wider, I guess. Much wider.

So you don't wander across that border unknowingly. You have to get across that river. It is something you do deliberately. And with planning.

So he had denied the presence of Nicaraguan troops. I had a lengthy meeting with the Speaker of the House of Representatives yesterday, and he told me about a telephone call he had from the Foreign Minister of Nicaragua, telling him that they were withdrawing the troops.

So I do not know which one of them was lying, Ortega or D'Escoto. But one of them was. Maybe both of them were.

Senator **Kasten**. Both.

Secretary **Shultz**. We would like to see them withdraw. And one of the reasons why we are raising so much public clamor about this, and others are, and one of the reasons for making a visible show of support to the Honduran regime, is to let them see how seriously everyone takes this, and maybe it will cause them to withdraw.

No doubt they will withdraw if they accomplish all their objectives. But we want them to withdraw first.

Now, as of the last intelligence I saw, there was nothing that we saw that indicated they were in the process of withdrawing, but it may be that they are.

Chairman **Chiles**. Senator Wirth.

Senator **Wirth**. Thank you, Mr. Chairman.

Mr. Secretary, I want to thank you for being here this morning, and going back to your opening statement, thank you for your, I think, rather extraordinary efforts in the Middle East which we all appreciate and support in every way we can. I also want to commend you on your statement about drugs this morning, and I hope that the sense of urgency that you are communicating gets communicated to all of us and to the country.

I would like to follow up on the Middle East, but the topic of the morning, unhappily, I think is Nicaragua. And let me ask you a few questions about that to follow up on some of the other statements that have been made.

In your opening statement about the letter that had come to you from the President of Honduras, you were careful to say that one of our responses was to send some 3,200 or 3,600 troops. What are the other responses we have had to the President of Honduras?

Maybe I misunderstood your statement.

Secretary SHULTZ. Yes; well, we have responded by diplomatic efforts in support of the point of view of the Government of Honduras which we share completely. We have responded by sharing certain kinds of information that we have that they are interested in and by giving them assurance that we will stand by them, and this is a visible thing.

Senator WIRTH. Are there any other military responses?

Secretary SHULTZ. We have not been asked for anything as of when I last saw, but if there are things that are requested, we will certainly consider them.

I was a little hesitant in response to Senator Conrad. We have not had a clear request, as I read out, but I was just wanting to be very, very careful that I did not say something that might be even slightly inaccurate. I am trying hard to hew to that line.

Senator WIRTH. Have Honduran troops moved up to the border?

Secretary SHULTZ. I do not know the answer to that question.

Senator WIRTH. That would be important for us, I would think, and for the American people to know, that if this were really a serious border incursion that, in fact, the Hondurans had responded by moving up to the border. That this was not just something that they were just turning to us to do or was a political move.

Secretary SHULTZ. Well, of course, there is a political move in the sense political meaning that you raise the visibility of the objections to this effort, and you try by that means to turn it back. There have been occasions, one occasion in the past—as Senator Kasten, I think, brought out—where we were requested to provide helicopter lift to Honduran forces, which we did on an earlier occasion. And I do not believe we have had that request as of now, but I am not absolutely sure. It is a fast-moving situation, and I can be behind the information curve here.

Senator WIRTH. In this moving situation, what are the circumstances under which we would commit combat troops to the combat area?

Secretary SHULTZ. Well, I do not want to try to be too precise about an answer to that question. I think it is important that people know that the United States will fight. But we do not have any plan to get involved in a direct military way. There is no request for that, and we do not have any plan for it.

Senator **Wirth**. If those circumstances exist and we are prepared to fight, would that be troops from the 82nd Airborne or the 7th Infantry that would be committed? Or would there be other troops?

Secretary **Shultz**. Those troops are sent basically to an exercise area. They will take part in exercises there. They are lightly armed, and they are not set up for any major military missions. That is, they do not, for instance, have any heavy artillery or anything of that kind.

Senator **Wirth**. So if we were to fight, it would be other troops that would be fighting and not the ones that are there?

Secretary **Shultz**. Well, if we were to get into a military encounter, just how that would be sized and so forth obviously would depend on the mission that was assigned. And the military would have to design in response to that mission, and there is not any mission that anybody has been talking about at this point.

Senator **Wirth**. I am trying to get a handle on the depth of our military commitment there. Will we be participating in the evacuation of the contras?

Secretary **Shultz**. Well, I hope that the contras, the freedom fighters will stay and do what they want to do; namely, try to preserve the freedom and independence of their country. I have always resisted these efforts to turn the so-called contra aid package into a refugee package. But, certainly, one of the consequences of removing our support from them, and particularly as we see what is going on right now, will be to create, no doubt, a flow of refugees. And Honduras is very concerned about this because they will come into Honduras, and they will say to us: You must take these refugees. Personally, I would feel that morally we must do that.

But I might just say in passing that our refugee budget—I know we cannot have any supplementals and so on, but our refugee budget is strained, our numbers are strained because we see a picture in Southeast Asia; we see things happening in Eastern Europe and in the Soviet Union, Armenian refugees coming our way, plus the Central American situation. So the planning that we have is strained.

But, at any rate, these are concerns that people have.

Senator **Wirth**. Thank you, Mr. Chairman.

Chairman **Chiles**. Senator Grassley.

Senator **Grassley**. Mr. Secretary, I would like to see people from your highest level to whoever is spokesman for the State Department, every time they talk about this, they remind the American people of the tremendous Soviet military aid to Nicaragua, which I understand has been over the last several years, each year, $500 to $600 million. Is that still our understanding that there is that kind of military aid coming in?

Secretary **Shultz**. That is the description of what has been happening. And as I said, our observation is that the flow of Soviet military assistance so far this year is fully comparable with the same period last year, perhaps slightly above. So there is a very strong Soviet military support.

Senator **Grassley**. I only say that as advice because, you know, people just think about what it is costing the American taxpayers in our involvement as if we are just interfering as opposed to trying to stop the establishment of a Soviet beach head.

Additionally, in regard to the President of Honduras request to us and our response to that request now for military people to be in Honduras, is that request and our response strictly bilateral, or is it under the Rio Treaty?

Secretary **Shultz**. In making his request to us, President Azcona cited various international types of obligations, in addition to the understandings that have been made between President Suazo first and then President Azcona and President Reagan. So they are a combination of things. Once again——

Senator **Grassley**. Is the Rio Treaty one of them?

Secretary **Shultz**. Yes, of course.

Senator **Grassley**. It is. OK. I think that answers my question on that point, then, unless you want to elaborate.

Secretary **Shultz**. No; some of these things I have here I am allowed to read from, and some I am not.

Senator **Grassley**. OK. Then, Mr. Secretary, I would like to ask a question on Afghanistan, if I could.

Under the proposed agreement, at least as I have been able to understand it, on Soviet withdrawal from Afghanistan—maybe the term "agreement" is not quite the word to use at this point. But, anyway, under the suggestion, the United States suggests it will cut off aid to the Afghan freedom fighters if the Soviets make symmetrical cuts in aid to the Kabul Government.

If that is correct, could you define for me and describe what symmetrical means in this context and some of the criteria for it?

Secretary **Shultz**. Well, it would mean that we do not have any continuing military supply relationship with whoever it is that you are supplying. We have made a clear point that we would expect to continue our so-called humanitarian assistance—that is, the provision of food and clothing and so on—which will be a continuing need. And, of course, if and when the Soviets withdraw from Afghanistan and the refugees return to Afghanistan, which is in the millions, three, five million people, then the needs for humanitarian assistance are going to be very large. We are thinking about how that can be organized. But that would have to continue.

Senator **Grassley**. If the Soviet Union continued military aid to the Kabul Government, would we continue with the arms coming in as we are now?

Secretary **Shultz**. Let me describe to you the structure of this negotiation. It is being conducted under the auspices of the United Nations, and the principal parties, so to speak, to it are the Afghan regime, which is a Soviet-sponsored regime, and the Government of Pakistan. The talks are so-called proximity talks.

Now, the Soviets are there, and obviously we and the Pakistanis and other countries discussed what is the right strategy. But, basically, this is Pakistan in the lead because they are there on the border. There are three million or so refugees in Pakistan, and they have the leading role.

What people have worked on over the years is a document with various kinds of undertakings to be made in it that essentially gets negotiated that way. Then the question that will be posed to us is: Will we be a guarantor of what is agreed in that setting? And we then have to look at what is agreed and ask ourselves if that is something that we can agree to. We are not bound to agree to it.

So we have said quite a few things about what we think is important to have there. We have said it is important to have a clear withdrawal timetable. It is important that the timetable be front-end-loaded so that, say, half the troops are out within 3 months.

Senator **GRASSLEY**. Well, have not you also——

Secretary **SHULTZ**. And so on. And there is also there a statement about the end of a flow of military supplies, and we have said that, as far as we are concerned, we will not sign on to a document where we undertake to stop military supplies to those we are supporting unless the Soviet Union does likewise. So that is just our statement about what we require as a guarantor.

Now, there is a great deal more to this, as you, I know, have followed very closely and worked on this, that I would be glad to talk about, but I think it should be in a closed session.

Chairman **CHILES**. Senator Hollings.

Senator **HOLLINGS**. Mr. Secretary, let me commend you. I do not see how you keep all the balls in the air at one time, and yet I will be asking you for an elimination of the ambivalence of policy and the ambivalence of control in Nicaragua.

Number one, we are all to blame, and it is a national disgrace. The President wants humanitarian aid; the House wants humanitarian aid; the Senate wants humanitarian aid. I have talked to the leadership only last week of the Resistance in Nicaragua. They want humanitarian aid. I have talked to President Arias; he favors humanitarian aid. I do not know what they are telling you here. I talked to him myself in Honduras, Cerezo in Guatemala, and Cardinal Obando in Nicaragua. They all want humanitarian aid. Everybody is for it, but we cannot get it all on account of the intramural politics that we have got going on in this town, and we have got to clear that nonsense up and at least get the aid. That is the significance of your commitment last night as some symbol of support, more than anything else, that we are still supporting the Resistance there to this Marxist takeover, because my friend, Senator Grassley, it is all over with in a fashion. The middle class has left and gone to Miami or Costa Rica and Honduras. There are 200,000 in Honduras right now, refugees out of Nicaragua; a hundred thousand down in Costa Rica.

I talked to the upper class. That is two people. That is the Cardinal and Violeta Chamorro. They are the only ones. Violeta is afraid she is going to get killed. They are slandering her as a Nazi, an adulteress and everything else. I have got the TV film. Otherwise, the Cardinal is afraid to talk because he is trying to stay with his flock and stay with the Resistance. He sees the United States backing off from the Resistance, so he is electing to stay with his flock. So he will not make any kind of statements that they can exile him for.

Having said that, I ask who is in charge down there, as they see it. For example, when you ask the Resistance, Who do you deal with? they say Colin Powell, national security adviser. Now, the last two national security advisers that have took on this role have been indicted, and I can tell you, Colin is not going to be running this one and he is too busy otherwise.

Then I ask you, and obviously it cannot be Elliot Abrams because he will not even be allowed up here to hearings, and you cannot run from Moscow to the Mideast and back here and back over again. You have got to give us somebody in charge of that policy. Who is in charge of the policy now?

Secretary **Shultz**. The President.

Senator **Hollings**. Well, heavens. Well, we have got to get somebody we can work with, obviously. [Laughter.]

We are working with the President. I do not mean it that way. The President is in charge of all policy. But, I mean, who do we work with directly in the Congress, and who really comes and stays on top of this problem when you are gone? The President, then you, but I am trying to get the one who is the working operative so we have got some control, and then eliminate not only the ambivalence there when you say we are down there, we want the people to know that the United States will fight; and then you tell the Senator in answer to the question, why, they are not there in a shooting capacity.

You see, I spent all week long telling them the Marines were not going to come in. That fellow Arias, he talks about moral authority, moral authority. He will not even defend his own neutralism. And I said what is about this moral authority when the people you are dealing with do not have any morals? He said, well, he expects the Marines, then, to come in and save him. And I am trying to tell him that the people of America are not of that mind, and we have not educated them to that point. And maybe you and I and the administration and the President ought to start doing it. But there is a tremendous ambivalence. You can tell from the questions here there is a sort of nonpolicy.

I spent all week long telling him the Marines are not going to come, and I get home and they start sending in the troops. And I like that symbol of support, I like that, but we had better get with it one way or the other. Because I happen to believe and definitely feel the Sandinistas have taken over. They have changed the currency. They have, as a result, caused strikes by their own Sandinista unions. They killed two union members last Tuesday. Last Sunday, with 400 mothers marching, they attacked them with 5,000 of these turbas, goon squads. They have moved up into not only the border, but they are moving in and giving added support. The added support you are talking about of the Soviets is going right straight up to the guerrillas against Duarte in El Salvador.

So they are on the move up the line, and Cerezo knows it because they are going to be stepping up against him in Guatemala. So we have got a real problem on our hands, and I think we ought not just talk about are they over the river or are they not over the river or whatever it is. You have got to talk in a general sense where this movement is. Nicaragua is a Soviet military encampment, and just the poor that cannot get out are left there.

It is a sad, sad situation, and the contras are fighting. And the symbol that you have given them last night is important, but I hope we can eliminate this ambivalence and get one policy and one control point that we all can work with.

Secretary **Shultz**. Senator, I agree with you that we have to describe this problem accurately to ourselves, and I have tried to do that here. I agree with you that while it is always interesting to know that there is a river there and you have to consciously cross the river, you do not just wander across and so on—and people are interested in these kinds of things. Nevertheless, the important point is the bigger point.

Now, as far as the President is concerned, I doubt that there is any subject in the field of foreign policy that has commanded his attention so much as the problems of Central America. His policies and approach have been laid out repeatedly, perhaps as dramatically as any time in the spring, I believe, of 1983 at a joint session of Congress called especially for that purpose. And the set of objectives and methods of dealing with them that he laid out in that speech represent a continuing policy, and it has been steady and pursued.

Now, our problem is that we have not been able to get complete agreement to that policy. The vote in the House of Representatives in February against the President's request was a deep blow, and it has disrupted us. That does not mean we do not still have a policy. We do. We have to figure out how to cope with the fact that the House of Representatives did not support the very modest request that was asked for.

We are doing our best to cope with that, and we are not going to give up on this problem by a long shot. But we have to realize we have a problem here. And once we take that on board firmly again, as we periodically do, then I think probably some sensible action will follow from it.

We do not have that much time because, at least in terms of this military action, it can flow very fast. And before you know it, your freedom fighter force has been badly damaged, as they have been damaged by the House vote. But, still and all, we have got to put these pieces back together for the very good reasons that you set out.

As far as our own work in the administration is concerned, the President is the boss and anybody who has served around him knows that. He is very strong and firm and makes all these basic decisions. We have, I think, right now a very good set of working arrangements in which General Colin Powell, as the NSC adviser, has a coordinating role, and he is performing it beautifully. I speak for myself, but I am sure others, in saying that he is a pleasure to work with. He is knowledgeable; he is energetic; he is wise. And I personally am very glad to be able to work with him.

Chairman CHILES. Mr. Secretary, we said we would get you out of here at 11:30. We are going to do that. We have got about 7 or 8 minutes. Senator Domenici is going to ask you some questions, and then I will try to add some questions.

Senator DOMENICI. Mr. Secretary, first, I want to make an observation. I did not do it well enough with reference to your observations about the drug problem. Frankly, we have had in this committee a serious discussion about the American economy and where we were as a Nation in terms of our strength. I would just like to echo, to the extent that it might have some impact on you and anyone else, that I believe we are making a grave mistake if we do not look at the drug problem on the streets of the United

States, in grade schools of the United States as a possible significant contributor to America's decline.

If we are not able to get the drugs off the streets of this country and out of the schools and out of the homes of this country, I honestly believe, while we cannot quantify that like we quantify GNP and unemployment and the like, I think it is a true threat to America's future. And I compliment you for your statement. I hope with reference to foreign countries that we help, and I know it is complicated. But I hope you will be extremely tough in terms of those that are our allies that we are helping, in terms of their commitment of cooperation with reference to drugs.

Now, Mr. Secretary, having said that, I want to make another statement. I happened to be a Senate adviser to the Kissinger Commission. If you will recall that, it has almost faded into the past. But in January 1984, that commission, made up of a very broad spectrum of Americans, concluded unanimously—while they disagreed on one issue, they concluded unanimously that the Soviet involvement with Nicaragua—and I almost quote verbatim—was a security threat to the United States. I think we continue to dance around that issue because we have been unable to convince our people that this is a very, very serious problem. You can see it now in the surrounding democracies. They are next. You can see it in the pictures we are able to get out of the tremendous military capacity that has been put into that country.

Now, I ask you, you have dealt with Gorbachev over and over. You have talked with him at length on issues, and you have shared that with us in a very good way, both publicly and in private sessions. Could you share with us your feelings about what does the Soviet Union think about Nicaragua. How do they relate to it? And what do you think their intentions are with reference to continued military supply? And how do they view that piece of geography in a small country in the midst of this hemisphere in terms of their world power?

Secretary **Shultz**. I think the best way to answer that question is not so much sort of speculation about what may be in their minds, because we do not know that, but just by looking at what they do. And what they do tells you a lot.

They have had what you can only describe, given the size of the region and the country, as a massive military relationship with Nicaragua. They have been pouring in military equipment by the thousands of tons and by the billions of dollars when you add it all up. It makes us look like a penny-ante contributor, even when we had our $100 million program, compared with what they have done. They are investing more money in Central America and the Caribbean than we are by a long, long shot.

So they say that they are just trying to help out their friends, but I do not think that is probably an accurate description. You have to look at what they do.

Senator **Domenici**. Thank you, Mr. Secretary.

Chairman **Chiles**. Mr. Secretary, I want to compliment you on the statement that you made in regard to drugs and terrorism. And I want to tell you I think that is very healthy. I also want to note that is the first time I have heard you lead off in speaking that way. I think that is awfully important, too, especially when we see, according to your own report, the production of opium, heroin, marijuana is actually going up in most of the countries that we are certifying as adequately performing on narcotics control.

It is obvious, another thing that concerns me, and this is more maybe as a statement than a question. I see in the New York Times, "Let's quit the drug war," by David Boaz of the Cato Institute. He says we have lost the war, we ought to quit, and a more sophisticated analysis suggests that the high cost of drugs as a result of their prohibition forces drug users to turn to crime to support an unnecessary, expensive habit. We can either escalate the war on drugs, which would have dire implications for civil liberties and the right to privacy, or find a way to gracefully withdraw.

Now, my gosh, when that comes out of a conservative think tank, the Cato Institute, you know, how in the world do we quit this fight? How can we do that when we see the implications for our young people, what it is costing us as a country, what it is costing in lives? I think that we have got to get our mind around the fact that everyone has to lead with this. You do. We have got to get it in every area. The Congress is only awakened to the fact that we have got to do something on the demand side in the last year or so that we have been looking at enforcement.

I just raise that as a statement.

Secretary SHULTZ. I agree with you.

Chairman CHILES. Senator Quayle is here and wanted to ask a question, if we could allow him to ask one brief question.

Senator QUAYLE. I will try to be very brief.

Chairman CHILES. I told him we would get him out of here at 11:30.

Senator QUAYLE. I just want to make one short statement just to see if I get the flavor of this Honduras situation.

There is no doubt at all that, in fact, the Sandinistas have crossed the border and are in Honduras. That is fact.

Secretary SHULTZ. That is a fact.

Senator QUAYLE. Let me make just a very brief summary of my perception on Honduras. I just want to see if you think I am right or wrong. It seems to me that the reason that we honored the request and are going ahead with the deployment of the troops–which I support–is because there is probably a perception, perhaps, in Honduras about our commitment and our word and how this whole contra issue is going to resolve itself. And it seems to me that because of what has happened with contra aid here in the Congress that we have got to take extra efforts to show political support for what is going on in Central America and our ally in Honduras, because of the division over the issue in this government.

That is my feeling of the situation. I just wondered am I generally right or wrong?

Secretary SHULTZ. I think you put it exactly right. People are always saying, Does the United States have staying power? Will we pull out on our friends and leave them high and dry? And they have reason to scratch their head, and we are trying to produce the reverse.

All these things have worldwide ripples. The fact that the President sent ships into the Persian Gulf to protect our interests has made a big difference. And the fact that he did it even though there were a lot of people opposing him, and now people are basically supporting and other countries have come in and so on, tends to reinforce that. But it is a problem, and we have to work at it. You are hitting it exactly right.

Chairman CHILES. Mr. Secretary, we want to get you out on a positive note. The positive note is that I think, we are a pretty representative committee here. And I think it was pretty interesting from the flavor I got from the questions and everything else, it was that Mr. Ortega has overstepped and has gone back on anything to do with the peace plan. I sensed the feeling here that we would like to do something about it. Thank you.

[Whereupon, at 11:33 a.m., the committee adjourned, to reconvene at 2 p.m. the same day.]

WRITTEN QUESTIONS TO SECRETARY OF STATE SHULTZ AND RESPONSES

STATUS OF RECOMMENDATIONS

Question 1. In 1986 the Committee on Research for the Security of Future U.S. Embassy Buildings issued a report which included 39 recommendations under the heading Performance—Based Criteria and Recommendations (Chapter 6):

(a) Which of these recommendations has State fully implemented?

(b) Please provide details regarding each of those recommendations which are difficult to undertake and implement.

Answer. Of the 39 recommendations:

25 have been implemented;
5 are in the process of being implemented;
7 have been partially implemented; and
2 have not been implemented.

Following is detailed information on each recommendation:

1. Site selection criteria and procedures.
   Status: Implemented and codified in A/FBO/PMC/ETG Program Management Manual (Book 2, Design Management). The recommendation to assign personnel permanently to the site evaluation teams is impracticable.
2. Site size and perimenter standoff distances.
   Status: Implemented—waivers requested from Assistant Secretary for Diplomatic Security.
3. Prescreening of sites.
   Status: Implemented, but without temporary assignment of personnel.
4. Advance preparation for site selection.
   Status: Implemented—initial data developed by Post and expanded upon during introductory visit by pre-site selection team.
5. Site selection team.
   Status: Not implemented—interdisciplinary teams are used, but resources do not exist for permanent site selection teams.
6. Adjacent land purchase.
   Status: Implemented, i.e. La Paz—however, budgetary and resource constraints limit us to doing this only where critical security considerations exist.
7. Site security analysis guidelines.
   Status: Implemented through A/FBO/PMC Sverdrup ETG, Program Management Manual, Book 5, however, there is a continuing effort by DS and A/FBO to improve upon these guidelines.
8. Site security planning guidelines.
   Status: Implemented through A/FBO/PMC Sverdrup ETG, Program Management Manual, Book 5, however, there is a continuing effort by DS and A/FBO to improve upon these guidelines.
9. Site security design guidelines.
   Status: Partially implemented through A/FBO/PMC Sverdrup ETG, Program Management Manual, Book 5. Will be addressed in findings of NAS Appendix 3 DOS (A/FBO-DS) review committee.
10. Site perimeter.

Status: Implemented.

11. Site access points.
Status: Implemented—on a case by case basis DS determines access requirements.

12. Onsite circulation and parking.
Status: Implemented.

13. Chancery building program modifications.
Status: Implemented.

14. Designation of blast and arson risk areas and containment effects.
Status: Implemented, but certain aspects will be addressed in findings of NAS Appendix 8 DOS (A/FBO-DS) review committee. Some areas are also subject to continuing research.

15. Secure areas and safe havens.
Status: Implemented.

16. Separation of hazardous occupancies.
Status: Implemented.

17. Protection of exterior walls and openings.
Status: Implemented.

18. Protection of exterior walls and openings (RF shielding).
Status: Implemented.

19. Protection of systems and equipments.
Status: Implemented, however, there is a continuing effort by DS and A/FBO to improve upon the criteria.

20. Protection of power, waste, water supply, and communication lines.
Status: Partially implemented. Certain aspects will be addressed in findings of NAS Appendix 6 DOS (A/FBO-DS) review committee.

21. Site self-sufficiency.
Status: Implemented.

22. Monitoring and control.
Status: Partially implemented, certain aspects will be addressed in findings of NAS Appendix 7 and 8 DOS (A/FBO-DS) review committees.

23. Design Criteria format.
Status: Implemented, however, there is a continuing effort by DS and A/FBO to improve upon the criteria. Mandatory training is not required but security briefing are provided and there is continuous interaction with A/E on all security matters.

24. Integrated data base.
Status: Partially implemented. With the assistance of Sverdrup corporation's Embassy Task Group, A/FBO has begun the process of strengthening its records management and document control processes that form the baseline for an integrated data base. In addition, A/FBO's Resource Management office is completing an extensive contract study of automation needs. The results of this study will be available in April 1988. Based on the conclusions and options identified, A/FBO will begin its investment in a major new Information Processing System (computer hardware and operating system(s)) needed to support the development and maintenance of an integrated data base as envisioned by the NRC.

25. Space programming.
Status: For post—FY 1988 capital projects budgeted, the space program process has been modified to include verification of personnel assigned or to be assigned to post for all agencies; as well as identification of specific functional or program space requirements. This process is being implemented by the new A/FBO Planning and Programming Division. Post requirements are verified and concurrences obtained from Washington headquarters authorities for all agencies to be housed in the new facilities.

26. Standardized components and large-scale procurement.
Status: Partially implemented—this will be an ongoing effort to identify areas where standardization can result in large procurement of similar subcomponents. Recent developments in this area include the Pre-engineered Interim Embassy Study Group.

27. Procurement of architectural and engineering services.
Status: Implemented. Rather than expand the Architectural Advisory Panel, A/FBO has established a Pre-selection Board composed of representatives of A/FBO and ETG (Sverdrup Corp.). This Board consists of all the necessary disciplines to properly assess the capabilities of firms. Further, pre-selection criteria has been revised to emphasize the requirements for security capability. Firms

that have had previous State Department experience are not excluded from consideration.

28. Program management.
    Status: Partially implemented. The Comprehensive requirements identified in the recommendation are recognized and accepted by the A/FBO management team. As resources and time permit, they will be achieved.
29. Project administration.
    Status: Implemented.
30. Security aspects of procurement.
    Status: Implemented.
31. Cost considerations.
    Status: In process.
32. Building operations and maintenance.
    Status: Implemented with the exception of regional maintenance assistance staffs. The FY 1989 Congressional Budget request for A/FBO includes funding for a new Facility Maintenance Assistance Center in Europe to support posts in the Eastern Bloc.
33. Post occupancy evaluation.
    Status: Implemented—documentation has been prepared for Post Occupancy evaluation. As Embassies are completed, Post Occupancy Inspection will be conducted.
34. Building information management systems.
    Status: Not implemented (but planned for the future).
35. Ongoing research program.
    Status: An R&D program has been incorporated into the recently established Applied Engineering Program, with funding for projects requested for FY 1989. The position of R&D Engineer has been created in A/FBO and has been temporarily filled with TDY personnel. Assignment of a permanent full-time engineer should take place within 6 months.
36. Security impact assessment development.
    Status: In process.
37. Physical elements for site security.
    Status: In process—this will be an ongoing effort in R&D.
38. Development of new enclosure systems.
    Status: In process—this will be an ongoing effort in R&D.
39. Development of door and window systems.
    Status: In process—this will be an ongoing effort in R&D.

REVIEWING SECURITY DEVELOPMENTS

Question 2. Commercial and industrial interests have responded to the increased use of terrorist violence as a political tool with the introduction of numerous processes, procedures, and equipment to enhance security.

(a) What process has been established for receiving, reviewing and evaluating these developments? Is there an element within State that is responsible for systematically analyzing the merits of those most promising ideas or suggestions and building them into some formal evaluation process?

Answer. DS receives numerous requests concerning processes, procedures, and equipment proposals each year. These are evaluated by personnel in various offices who have the appropriate expertise to analyze them. The Office of Security Technology evaluates and responds to matters concerning countermeasures and electronic security equipment. Procedural suggestions would be jointly considered by the Offices of Overseas Operations and Procedural Security. Physical and construction security matters are addressed by the Office of Physical Security Programs.

PROCEDURES FOR MARKETING

(b) If a company with new technology or capability in security wants to market its services to the Diplomatic Security and embassy construction programs, what steps should that company take?

Answer. In order for a company to market its product, it should contact one of the above offices of the Bureau of Diplomatic Security. If the product lies outside the initial office's area, it will be readily referred to the appropriate office. The product or service would then be evaluated and, if useful and fundable, would be obtained through the normal procurement process. In addition, any new product requirements identified by the Department of State are routinely included in the Commerce Business Daily.

COMPUTERS SECURITY ROLE

(c) What role has the use of computers had in assisting State to coordinate security related plans and procedures? Could they play a greater role?

Answer. Each month, dozens of Public Access Control, New Office Building and post-generated security improvements requiring engineering support are tracked by a computer program. The program helps make the best use of available resources, and allows us to schedule equipment, wire, installation material and installers to posts on a timely basis. (At present, 161 projects appear on this system.) As equipment is installed overseas, it is added to a computerized inventory program, which allows our office to accurately schedule needed maintenance support and to order the correct quantity of replacement equipment each year. Needed equipment, wire, supplies, shipping support and other items are identified on a budget program. This program allows us to both keep accurate records of our expenditures and to prepare out-year budget submissions. We are also continuing to examine the use of computers to assist our engineering staff in design work as well as mathematical modeling of needed security enhancements at proposed new office buildings overseas.

IN-HOUSE CAD NOT AVAILABLE

(d) How has State employed or adopted the use of Computer Aided Design (CAD) in the design process? For design review? For emergency operations?

Answer. The Office of Foreign Buildings Operations (A/FBO) does not accomplish facility design utilizing in-house design staff, but contracts with private architectural-engineering (A/E) firms to accomplish, under A/FBO review and direction, the design and produce the required construction documents. Many of these private A/E firms under contract to A/FBO, utilize CAD systems to accomplish much of the design/drafting required.

At present, A/FBO does not have an in-house CAD system for use in reviewing A/E produced designs. A/FBO has a study underway to develop an integrated office automation and Computer Aided Design/Computer Aided Engineering System Design (CAD/CAE) that will support all A/FBO automation needs. The final study report will be delivered at the end of April 1988. The introduction of CAD/CAE tools into A/FBO involve difficult and complex considerations. Among factors under consideration are:

Computer facility hardware and operating system support;
Selection of the appropriate CAD/CAE software applications;
Assessment of training needs;
Staffing and recruitment of support personnel versed in the technology; and
Definitions of life-cycle requirements.

We believe that the CAD/CAE tools will become an important element of our design, engineering, space management, and maintenance programs. However, the changes envisoned will take time and resources.

In the interim, the following actions also are being considered:

1. Establishing an initial design group within A/FBO, equipped with CAD capability, to accomplish project designs and particularly those requiring priority quick-response time.
2. Requiring all private A/E firms under contract, who have established CAD systems, to submit their CAD generated output with the necessary neutral digital data bases that are machine and system independent to ensure compatibility with the operating programs of whatever CAD system A/FBO does install.

EMBASSY PROFILES LIMITED

Question 3. Given the capability to rapidly retrieve graphic and associated narrative data through the use of CAD, what capabilities does State have to maintain current embassy building plans? For example, given an emergency (such as the Iranian hostage situation of a few years back) could State through FBO or the Office of Diplomatic Security retrieve current, reliable building plans of that embassy? Would you have a complete inventory and location of all critical equipment as well as the specifics on all building services and equipment available here in the United States for contingency operational planning?

Answer. There are several aspects to this question. A/FBO does not have at present an in-house CAD system, or maintain an automated inventory of "current" embassy building plans. It does maintain an inventory on microfilm of the plans for most embassy buildings worldwide. However, these are mainly a record of the as-built plans prepared at the time of construction completion. Except for recently constructed facilities, these plans may not reflect existing conditions. The plans of all building facilities now being constructed will be added to this inventory. When a

CAD/CAE system is installed, all current and reasonably current building plans in the inventory, not already available in suitable digital data bases, will be converted and maintained in digital form.

We recognize the potential of CAD/CAE system support during the life cycle maintenance of our facilities. The value of being able to review and amend the "as-builts" as building structural, electrical/mechanical, and operating systems require modification is clear. The implications of a capacity to retrieve and view such data during a crisis is obvious. However, the state-of-the art in this area is not fully developed and perhaps, more importantly, the enormity of the task to digitize and maintain these details is sobering. Once we have developed and installed our in-house computer capacity, we will proceed to create data bases for the new facilities and expand our inventory as time and resources permit.

ENGINEERING PROGRAM ESTABLISHED

Question 4. FBO has made major efforts to revised chancery design criteria and to upgrade the security-related performance of conventional building systems, materials and components. In 1986, the National Academy of Sciences recommended to the State Department that it establish, within FBO, a program to develop and evaluate new technical approaches and systems, suggesting that innovative building techniques—both design and construction—may offer significant security advantages. What steps are being taken by FBO to examine innovative building systems for embassy construction?

Answer. A/FBO has recently established an Applied Engineering Program which will examine building systems and building system components to optimize and provide innovative solutions to our program needs. The FY 1989 budget for this program includes projects for: the development of a prefabricated steel frame building system hardened to resist blast, the development of cost effective, constructible and innovative perimeter wall designs, and the development of a generic blast hardened window. This program is being controlled by the R&D Engineer in A/FBO/BDE with input from each division within A/FBO.

Further, two joint DS/FBO task groups have been formed to examine innovative building system concepts. One is the Core Embassy Task Group which is examining various options of secure area configuration which might reduce the area required for installation of RF shielding and, thus, cost of construction. The other is Pre-Engineered Interim Embassy Task Group which is examining the possibility of using pre-engineered modular design/construction for "interim" office building, at low-threat and relatively small posts that urgently require new facilities. While not meeting full security criteria for high and medium threat posts, these buildings would provide a significant improvement over the existing physical and technical security posture at these posts. The 100 foot setback would be maintained and the buildings would be designed to permit easy construction upgrades should the threat level increase. This concept may provide a relatively low cost methodology for meeting urgent facility replacement requirements at low threat posts. Our objective is to provide an operational and functional Embassy that meets optimum security in a cost effective manner.

TACTICS OFFSETS DISTANCE

Question 5. A number of current Department of State and U.S. Government facilities around the world cannot be protected through increased set back distances from uncontrolled areas. Some of these facilities are in rental buildings and some are in very compact urban environments.

What alternative to increased set back has Department of State explored to provide either permanent or interior protection to the facilities?

Answer. In order to afford maximum protection possible to our personnel, each building is protected to the extent feasible by solid perimeter walls, bollards or planters, vehicle barriers to discourage vehicular bomb attacks, blast resistant doors and windows at the lower levels, and shatter resistant window film at the upper levels. Other measures include the reorganization of work spaces to remove personnel from exposed areas. We have also initiated development programs in areas such as blast abatement walls and computer modeling to evaluate the blast effects on structures.

DEFENSE MEASURES IDENTICAL

Question 6. The primary thrust to protection of Department of State facilities from bomb attack has been to provide set back distances to reduce the blast effects from large (1,000 lb.) typically vehicle borne bombs. Most terrorist bomb damage and personal injury is caused by considerably smaller bombs (10–100 lbs.) in which defense measures can be considerably different.

What techniques does the Department employ to support "smart design" of integrated bomb defense measures for small internal or external bomb attacks.

Answer. The threat from a small bomb does not necessarily reduce the amount of protection required because the blast pressures from a small device close to the protected building can approach or even exceed that of a large vehicle bomb located over 100′ away.

Many of the defensive measures for protecting an embassy from a large bomb are also valid for protection from a smaller charge. Careful screening at the perimeter of the compound by trained guards, public access screening at lobby entrances, set back distances which prevent objects being thrown into the building, alarm systems to detect intrusion, personnel training on emergency procedures, coordination with host government EOD elements and liaison with intelligence agencies and the local government on potential threats are all examples of this type of overlap. These measures limit the opportunity to introduce a small device into the buildings and will limit the size of the potential charge. These are the most practical and effective steps that can be taken in light of the number and variety of buildings that require protection.

VARIOUS TECHNICS MITIGATES BLAST

Question 7. What technologies has State employed, through innovative design and unique material usage, to reduce or mitigate the effects of bomb explosions in or near a building?

Answer. The Department has conducted an energetic research program in areas of blast resistant windows, hardening of structural and wall elements, blast abatement effects of perimeter walls and computer modeling of blast effects. The technologies involved range from conventional materials such as steel and concrete to the use of polycarbonate laminates for windows. The development of setback distances and use of existing technology such as shatter resistant window film have also resulted in substantial improvements in protection.

Current State Department policy holds that operational security must be relied upon to intercept small explosive devices at the perimeter of an embassy. Because of the use of delta vehicle barrier systems to keep bomb laden vehicles away from building, the main explosive threat is therefore the off-site truck bomb. As a result of designing for this and other threats (forced entry, ballistics), there is inherent structural strength in the building system which will serve to mitigate the effects of bomb explosions in or near buildings. Secondly, A/FBO has incorporated progressive collapse structural design techniques into our buildings that will prohibit catastrophic collapse of buildings due to localized explosive events.

DEFENSE LONG-RANGE STRATEGY

FRIDAY, MARCH 18, 1988

U.S. Senate,
Committee on the Budget,
Washington, DC.

The committee met, pursuant to notice, at 10:06 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Lawton Chiles (chairman of the committee), presiding.

Present: Senators Chiles, Sasser, Grassley, and Nickles.

Staff present: Richard N. Brandon, staff director; and Doug Cook, group leader for national security.

For the minority: G. William Hoagland, staff director; and Richard Doyle, senior analyst for defense.

OPENING STATEMENT OF CHAIRMAN CHILES

Chairman Chiles. Today, welcome two distinguished witnesses to discuss national security strategy with us. Mr. Fred Ikle is a former Undersecretary of Defense, and Dr. John Steinbruner heads the national security programs at The Brookings Institution.

This year, in a look to the future, we heard a great deal of testimony about America's role in a changing world. Much of our current national security strategy was developed nearly a half century ago when our relative economic and military situation was much different.

The President's own Commission on Integrated Long-Term Strategy, which was cochaired by Dr. Ikle, recently pointed out that the People's Republic of China could, in the next decade, emerge as a very significant economic power.

It is clear we must begin to recognize emerging realities and adapt our national strategy to them. However, too often, our discussions and debate on strategy focus on how to prosecute war. In fact, our successes in the last half century have been in the way in which we have waged peace. The Marshall Plan, the NATO Alliance, the economic recovery of Japan, and the modern day miracle of Korea are examples of America at her best.

We should learn from these successes that the most important trade off questions are not necessarily those of ground, air, or naval forces, but between intelligence, diplomacy, and military forces.

President Eisenhower, who understood the limits of military power better than any President in our history, was able to preside over a $100 billion reduction in the defense budget and still improve our national security posture. He did this by vigorously pursuing the other two legs of our national security triad, intelligence and diplomacy.

Ike reminded us in his 58 state of the Union address that we must never become so preoccupied with our desire for military strength that we neglect those areas of economic development, trade, diplomacy, education, ideas and principles, where the foundations for real peace must be laid.

This is especially important in light of the new Soviet leadership. Former President Nixon described his meeting with the new Soviet premier as the most impressive performance in nearly 40 years of meeting with world leaders. This Soviet leader is obviously aware of the technological and economic problems in the Soviet Union and clearly wants to use an aggressive diplomacy to correct them.

Therefore, in order to develop an effective grand strategy, we must be able to coordinate every facet of national power to include economic, technological, and moral, and this obviously involves a broad national consensus on American values and priorities and how and when we will use power to protect them.

This consensus has been unfortunately lacking in recent years. If we are to move confidently into the 21st century, we must begin by building that consensus, and we hope the debate and discussion this morning will move us closer to that goal.

I am delighted to have join us for as long as he can stay Mr. Dardeneau, who is the chairman of the finance committee of the French National Assembly. We know that he could shed some light, perhaps, on our budget problems and tell us some about the French budget problems they have. I enjoyed meeting with him this morning and hope that he will be able to remain with us for a while.

We have a statement from Senator Domenici that will be entered in the record and he hopes to be with us shortly.

[The prepared statement of Senator Domenici follows:]

OPENING STATEMENT

HEARING ON STRATEGY

Senator Pete V. Domenici

March 18, 1988

[NOTE: DR. IKLE'S NAME IS PRONOUNCED "E-CLAY"]

WELCOME GENERAL GORMAN, DR. IKLE AND DR. STEINBRUNER. I LOOK FORWARD TO HEARING YOUR VIEWS ON OUR LONG-TERM MILITARY STRATEGY. THIS COMMITTEE IS INTERESTED IN REVIEWING OUR STRATEGIC OBJECTIVES IN ORDER TO PROVIDE THE BUDGETARY RESOURCES NECESSARY TO ACHIEVE THEM.

THE REPORT ISSUED BY THE COMMISSION ON LONG-TERM INTEGRATED STRATEGY HAS TRIGGERED A GOOD DEAL OF PUBLIC COMMENT. IT INVITES US TO THINK ABOUT THE FUTURE, AND THE THREAT TO OUR SECURITY WHICH WE MAY FACE OVER THE NEXT TWO DECADES.

IT ALSO REMINDS US OF SOME VERY IMPORTANT FACTS FROM THE PAST. I WOULD LIKE TO UNDERSCORE SEVERAL OF THESE FOR MY COLLEAGUES.

THE FIRST POINT I WOULD LIKE TO MAKE ABOUT OUR NATIONAL SECURITY STRATEGY CONCERNS STABLE BUDGETING FOR DEFENSE. WE CANNOT BE TOLD TOO OFTEN HOW IMPORTANT IT IS TO AVOID THE KIND OF ROLLER COASTER BUDGETING WE HAVE SEEN OVER THE PAST SEVEN YEARS.

JUST AS THIS PRACTICE MAKES IT DIFFICULT TO PROCURE WEAPONS AT ECONOMIC RATES, IT ALSO MAKES IT VERY DIFFICULT TO PLAN AND PUT INTO EFFECT A COHERENT NATIONAL SECURITY STRATEGY.

THE IKLE COMMISSION REPORT MAKES THIS POINT IN NO UNCERTAIN TERMS. OUR ACQUISITION PROCESS MUST BE LESS TIME-CONSUMING AND MORE INNOVATIVE. AND CONGRESS MUST SUPPORT THAT PROCESS WITH STEADY MODERATE GROWTH IN THE DEFENSE BUDGET.

A SECOND IMPORTANT STRATEGIC LESSON FROM THE COMMISSION'S REPORT CONCERNS NUCLEAR WEAPONS. WHATEVER CHANGES IN OUR NATIONAL STRATEGY WE MIGHT THINK ARE NECESSARY, I THINK IT IS MOST IMPORTANT FOR THE AMERICAN PEOPLE AND FOR OUR ALLIES TO UNDERSTAND THAT NUCLEAR WEAPONS ARE HERE TO STAY. THE NUCLEAR GENIE IS OUT OF THE BOTTLE FOREVER, SO WE MUST ACT WISELY TO MANAGE THE NUCLEAR COMPONENT OF OUR DETERRENT.

I BELIEVE WE HAVE MADE DRAMATIC PROGRESS IN THIS AREA-- MANAGING OUR EXISTING NUCLEAR STOCKPILE, DEVELOPING NEW AND SAFER NUCLEAR WEAPONS AND RETIRING OLDER WEAPONS FROM THE INVENTORY. WE MUST CONTINUE TO IMPROVE OUR STOCKPILE, AT THE SAME TIME THAT WE PURSUE ARMS CONTROL NEGOTIATIONS AND THE DEVELOPMENT OF IMPROVED CONVENTIONAL WEAPONS.

THE COMMISSION REPORT POINTS OUT THE DRAMATIC CHANGES THAT HAVE TAKEN PLACE IN OUR NUCLEAR WEAPONS STOCKPILE. THE REPORT NOTES THAT THE U.S. HAS REDUCED ITS NUCLEAR WEAPONS BY ABOUT ONE-

THIRD SINCE 1967. AND THE TOTAL EXPLOSIVE POWER OF OUR NUCLEAR WEAPONS TODAY IS ONLY ONE QUARTER OF WHAT IT WAS IN 1960.

PAST REDUCTIONS IN OUR NUCLEAR STOCKPILE--AND I AM TALKING ABOUT UNILATERAL AMERICAN REDUCTIONS--HAVE BEEN LARGER THAN THE TOTAL REDUCTION IN THE NUMBER OF SOVIET WARHEADS THAT WOULD BE ACCOMPLISHED BY THE INF TREATY COMBINED WITH THE 50 PER CENT REDUCTION BEING NEGOTIATED AT THE START TALKS. I THINK THAT THIS IS ONE OF THE MOST IMPORTANT WAYS IN WHICH WE HAVE MADE OUR DETERRENT A MORE "DISCRIMINATING" FORCE.

AND THAT LEADS ME TO A FINAL POINT ABOUT STRATEGY AND NUCLEAR WEAPONS. THE SENATE WILL SOON TAKE UP THE INF TREATY. MEANWHILE THE ADMINISTRATION IS NEGOTIATING A START AGREEMENT AND A VERIFICATION PROTOCOL ON TWO NUCLEAR TESTING AGREEMENTS--THE THRESHOLD TEST BAN TREATY AND THE PEACEFUL NUCLEAR EXPLOSIONS TREATY. OUR NEGOTIATORS IN GENEVA HAVE ALSO TABLED A NEW DEFENSE AND SPACE PROPOSAL TO RESOLVE THE ABM CONTROVERSY. AND THE CONVENTIONAL ARMS REDUCTION TALKS IN VIENNA HAVE RECEIVED NEW IMPETUS BECAUSE OF THE INF TREATY.

OBVIOUSLY ARMS CONTROL CAN BE A USEFUL COMPONENT OF OUR NATIONAL SECURITY STRATEGY. HOWEVER, AS THE IKLE COMMISSION REPORT POINTS OUT, WE ARE FOOLING OURSELVES IF WE VIEW ARMS CONTROL AS AN END IN ITSELF. IT CAN ONLY SERVE ITS PURPOSE IF THE AGREEMENTS WE REACH ARE SUPPORTED BY EFFECTIVE AND INTELLIGENT VERIFICATION, FOLLOWED BY A RIGOROUS COMPLIANCE

POLICY. I AM CONCERNED THAT WE ARE LETTING OUR INTEREST IN REACHING ARMS CONTROL AGREEMENTS OUTRUN OUR CAPABILITIES TO VERIFY THEM.

WE MUST THINK CAREFULLY ABOUT THE VERIFICATION TECHNOLOGIES WE PROPOSE IN THESE NEGOTIATIONS TO INSURE THAT THEY ARE IN OUR LONG-TERM STRATEGIC INTERESTS. AND TO DO THAT WE MUST INSURE THAT WE HAVE ALL THE RIGHT PEOPLE AND ORGANIZATIONS INVOLVED WITHIN OUR GOVERNMENT TO CARVE OUT A VERIFICATION STRATEGY AND DEVELOP THE APPROPRIATE VERIFICATION TECHNOLOGY. I INVITE OUR WITNESSES TO COMMENT ON THIS VERY IMPORTANT STRATEGIC ISSUE.

Chairman CHILES. We will start with Dr. Ikle.

STATEMENT OF DR. FRED CHARLES IKLE, COCHAIRMAN, COMMISSION ON INTEGRATED LONG-TERM STRATEGY

Dr. IKLE. Mr. Chairman, thank you for the invitation. Of all the many implications of defense strategy, the budgetary implications are of particular importance. I therefore welcome the opportunity to appear before your committee.

I shall just briefly allude to some of the points made by the Commission on Integrated Long-Term Strategy, to which you referred in your opening statement, and tied into the considerations before us.

It has become fashionable recently in the last few months or years to muse about some inevitable decline of the United States as a world power and to deduce from such a decline that our alliance system should be abandoned. Let me offer some points on this recent malaise.

Our commission developed some forecasts regarding the economic strength of the major powers. Economic strength, after all, is an important measure of military strength, though not the only measure, by any means.

Our economic forecast indicates that by the year 2010, the United States will continue to outrank all other nations in terms of its gross national product. Now, to be sure, the share of the world economy attributable to the United States will be less than it was in the 1950s or after World War II, but the total collective of the economies of our alliances will be stronger than ever.

Now, some people conclude from the decrease in the U.S. share of the world's total economy that we should retrench somewhat and withdraw from our alliances. I think a more reasonable argument is that the United States would have been better able, actually, to go it alone in the late 1940s or the 1950s than today because it was all that much stronger, and that today it is overwhelmingly in our American interests to keep our alliances together as a mighty force for peace and freedom.

Moreover, since the United States will remain by far the largest power in economic terms in our alliances, it falls on us to continue to exercise leadership. It is actually in our own national interest, I would argue, to try to guide and shape this powerful commonwealth of democracies towards a destiny which is consonant with our American values.

Now, exercising leadership does not mean assuming a disproportionate burden for the common defense. On the contrary, I would think sound leadership requires the kind of intellectual inspiration, strategic guidance and, as you mentioned, Mr. Chairman, diplomacy that will induce the allies fully to contribute in accordance with their capabilities and with their shared interests.

But for a defensive alliance, the core of this effort has to be a military strategy for defense, one that is appropriate for an alliance of democracies and conducive to a full sharing of burdens and risks.

And this requirement for such an alliance strategy calls for some radical adjustments in our present strategic thinking. The need for such adjustments is one of the key messages of our independent, bipartisan commission.

In particular, our commission stressed that we have to wean our allies from the reliance on threats of mass destruction as the response to major aggression. As an alliance of democracies, we cannot defend the member nations by threats that are expected to destroy all the allies if carried out. We must have, instead, militarily effective responses, responses that the people could support in time of crisis.

Now, this adjustment in the thinking of our deterrence doctrine is important not only to prevent us getting into a crisis for which we are ill prepared. It is important also today to make progress on burdensharing.

Reliance on mutual assured destruction as the over-arching response in our strategy will make our allies feel that the sharing of burdens is unnecessary or dangerous, or both. They will argue that to extend base rights will seem dangerous, for example; that to improve conventional forces will seem unnecessary.

Another point stressed by our commission which I would like to highlight again today is that for our alliance we need to focus our strategy on the more plausible contingencies of aggression; for example, a Soviet attempt to gain control of the world's oil resources in the Persian Gulf region.

We should not focus only on the extremes like the all-out Warsaw Pact attack on the Central Front in Europe. Our strategic thinking has been too much dominated by these extreme contingencies, for which we must be prepared but which are not the only contingencies.

As we look at the problems, for example, on the periphery of the Persian Gulf, we will discover that in terms of what you might call the military geography of the world, our position has sharply deteriorated since the 1950s. Why? Because the gulf region today is much more accessible to the Soviet military than it was in the 1950s and much less accessible to our military forces.

As a third point, let me just remind everyone here that the Soviet Union, of course, continues to modernize its military equipment, not only for the nuclear forces, but for conventional forces as well.

A particularly dangerous area concerns space capabilities that could be used in the event of a conventional war. In the event of such a conventional war, for which, after all, the Pentagon spends about 70 to 80 percent of its budget, the Soviets would have a massive capacity for launching satellites during war time and they could employ various capabilities for disabling many, if not all, of our satellites.

Thus, our military forces could be deprived of their eyes and ears for conducting that conventional war, while the Soviet forces could make continued or even expanded use of space assets. This is a fatal asymmetry that will face us in the 1990s which must be rectified, and the corrections, obviously, impose a demand on our defense budget.

It has been said in answer to the constant pressures for budget cuts deriving from our Federal deficit and other considerations that one way to save money would be to cut back on some of our so-called modernization of military forces, both the R&D efforts and the procurement of new forces, and that as long as we maintain the readiness of our forces, all is well.

The fact is that the readiness of our forces in 1988 or 1989 or 1990 will not help us in a crisis, Mr. Chairman, in the mid-1990s, 5, 10 years later, and since we cannot know whether Soviet foreign policy 10 years hence will be benign or whether it will revert to the aggressive actions that we recall from prior years, we have to spend the effort now to be prepared for a possible deterioration.

It takes some 10 years to complete most military R&D projects and another 10 years or so to field new systems. So if we are confronted with a different Soviet foreign policy seven, 10 years hence, a sudden new crisis, we cannot start our R&D to be prepared for then; we have to have that in our pocket.

The pressures on our budget force us to look in all directions for getting the most of our defense dollars. If I may, I think there are some areas where the executive branch and Congress can cooperate more effectively to get more for our money.

As you know, the Pentagon has prepared now for the second time a 2-year budget. The idea here is to get away from the roller coaster budget that we have had in all the past decades which leads to all these inefficiencies.

I do not know whether Congress can support a 2-year budget by participating in it perhaps not only for the authorizations initially, but eventually even for the appropriations. I am not sure that is asking too much, but it is a great, great step forward.

I see your French colleague there and, of course, in other countries there is greater efficiency in allocating. Particularly in France, for example, in allocating the budget that the executive branch proposes, there is greater steadiness.

Another step that Congress might take, if I may make further suggestions in this direction, is to reduce some of the inefficiencies imposed on our security assistance programs.

You mentioned, Mr. Chairman, in your opening remarks very correctly the efforts in the Eisenhower administration to move with diplomacy, the battle of ideas, intelligence. In those years, our government—the executive branch, the government as a whole—was less constrained.

In the last decade, a great many limitations have been imposed particularly on security assistance, which gives the tools to the kind of diplomatic effort you mentioned in your opening remarks that we should take, and these inefficiencies mean that we get much less for the small amount of money that is allocated to security assistance.

Overall, our commission concluded that on the margin a dollar spent for security assistance is probably the most effective way of spending money for national security. In short, this would imply a transfer from defense dollars to security assistance, if necessary.

But, lastly, we need to maintain a certain moderate growth in our overall level of effort, not a decline, a growth that would be consonant with our expanding national economy.

There have been years in the past when we spent less on defense, to be sure. There have been years when we spent more, but by and large the years when we spent less were often followed by crisis or, in the 1940s, by wars.

In the post-war years in the 1940s, we spent about a third in constant dollars of what we spend today on defense. Then we had the Korean war, and during those years we also had the violations of the Yalta agreement. We are still paying today for these major setbacks in our strategic situation.

Our deployments in Korea and our costs in Asia have gone up as a result of the Korean war in the 1950s and, of course, our costs for NATO are related to the fact that we did not maintain the letter and spirit of the Yalta agreement in the 1940s.

So while a skimping on defense in the late 1940s may have saved us money at that time, in some sense we are still paying for it 30 years later. This is the kind of lesson we also have to keep in mind as we work through the difficult adjustments in our overall budget.

Thank you, Mr. Chairman.

Chairman CHILES. Thank you, Dr. Ikle.

Dr. STEINBRUNER.

STATEMENT OF DR. JOHN D. STEINBRUNER, THE BROOKINGS INSTITUTION

Dr. STEINBRUNER. Thank you, Mr. Chairman. I also appreciate the opportunity to appear before the committee. I have prepared a statement which I will submit for the record.

Chairman CHILES. Your statement in full will be placed in the record.[1]

Dr. STEINBRUNER. Let me summarize very briefly what it is intended to say. The basic message is that we are entering a period in which rapid changes in international economic circumstances will predictably force, major adjustments in the posture of American security, and therefore in the defense budget.

These changes involve the internationalization of the economy, the state of maturation of the military balances, and the redirection in policy that is occurring in major countries throughout the world, particularly in the Soviet Union.

These conditions will require major adjustments in the fundamentals of our own policy, and we are likely to have difficulty in making them. The United States does not easily arrive at general national policy or establish a general strategy. We do not have a form of government that authoritatively establishes such things without very substantial consensus, and we have a difficult time achieving consensus.

The budget cycle will definitely be one of the main venues in which we struggle with these issues. We will do so by implication from a series of specific budget decisions. This committee will be in the middle of a major adjustment in our conceptualization of security.

Let me try to outline the major dimensions of this adjustment and the structural reforms, if you will, that are likely to be imposed upon us by these external circumstances.

---

[1] See p. 245.

The first of the emerging circumstances, and I think the most important, you have already identified. That is the changing international economic conditions. There, I would say, and do in my statement, that the point is not the relative decline of the size of the United States, which has occurred, or the emergence of any other national economy, which also is occurring, but rather the ascendancy of the global economy as a whole. All countries are increasingly involved in the international economy is attempting to assure strong domestic economic performance.

The real significance of this development is that it has altered the thrust of national policy throughout the world. Most countries are now concerned with economic performance and are looking to the international economy as a critical determinant of that objective. Moreover, they are looking to the United States, either tacitly or explicitly to provide leadership in structuring international economic conditions, since we are still the single largest economy and the one that emanates the most powerful technical impulses, producing the greatest momentum for economic change.

These circumstances do not dictate international retrenchment at all, in my opinion, but they do necessitate a refocusing of our own policy, putting the issues of military power more into the background, in recognition of the fact that for most countries the projection of power has become much less significant than it ever was. Although they are quite eager to defend their own territory, their interest in contesting opposing countries' territories has diminished very dramatically, and for very solid reasons.

Mainly, what most countries desire are economic circumstances in which they can prosper, and are looking to us for leadership in defending our traditional policy of openness of the international economy. These demands for leadership occur under circumstances in which our national leverage is diminished, in which therefore we must operate in concert with other countries, and in which our credibility depends upon bringing our own economy into better balance with the international economy. That means a fiscal adjustment. We simply cannot sustain the trade balances and fiscal deficits that we now have, and our leadership position in the international economy will depend mostly on our ability to undergo the necessary adjustment.

We also face a maturation of military power which is changing the circumstances of investment in two important ways. It is neither feasible nor desirable, to expand our forces or to seek any decisive shift in relative military advantage. We are in the business of maintaining but not expanding a very large establishment. We have forces, both nuclear and conventional, that do provide very powerful deterrence against attack and barriers against conventional invasion. Although we need to preserve these capabilities we do not have dramatic improvements in either regard that we have to go through. That is not the problem.

The dominant emerging problem is that controlling the interactions of these forces in crisis, an objective that requires stabilizing the size and operational practices of the opposing establishments. That is a much more severe security problem for the future than maintaining deterrence, important as that is.

Finally, in this background set of circumstances, we are observing quite a dramatic change in the thrust of Soviet policy very similar to the one that occurred in China a decade ago—a redirection of interest to domestic economic performance, a recognition of the need to emerge from economic isolation into some constructive interaction with the international economy, and an apparent subordination of military power under those circumstances. The Soviets are now talking about sharp reductions in strategic forces toward the levels required for basic deterrence and, even more significant, a restructuring of their conventional forces to put them into a defensive configuration. We may be skeptical about the sincerity of these declarations or their ability to carry them out, but we certainly cannot afford to ignore the obvious opportunity provided to restructure the threat and diminish the demands that it places upon us.

Given these circumstances, we face an inevitable of our own economy with respect to the rest of the world. We will certainly have to reduce our fiscal deficit or experience a process of economic degeneration that comes from what world markets will do to the value of the dollar if we do not.

In the course of that, there will be very strong downward pressures on the defense budget, and therefore powerful incentives to examine the efficiency with which we spend our money and the possibilities of reconfiguring international security in a way that imposes less burden on defense expenditures. These two methods together, I think, are likely to trigger a series of what I will call structural adjustments in our security posture, and let me list what I think they are.

The first will be or should be an optimization of the rate at which we replace our military equipment. During the past decade, we have increased expenditures on weapons procurement to the extent that we have begun to replace military equipment more rapidly than it actually wears out. There are some hidden inefficiencies in this practice that we can ill afford. In the first instance, it is out of line with the time it requires to master new weapons designs, and that fact produces the worst inefficiency. We force ourselves to produce in relatively large numbers models of weapons for which the design has really not been stabilized. We then either tolerate the decrease in effectiveness of those new models or we go through very expensive retrofit programs to fix them. We have gone through that experience so many times with past weapons that we should have learned a lesson, we should have realized by now that the appropriate objective is not developing weapons as rapidly as possible, but developing them and fielding them at an optimum rate. We are currently above that optimum rate and we will have to bring our rate of weapons replacement down to match it more closely.

A second, important structural reform, one that we eventually have to consider very seriously is to separate out the functions of maintaining the defense industry and its design and production capabilities on one hand and actually using them to procure weapons on the other.

At the moment, the basic maintenance of the industry is all tied up in weapons procurement, so that we cannot continue weapons designs as long as we should before we are committed to producing them. And in order to be able to do that, we will probably have to restructure the financing of the defense industry, recognizing that some portion of what we spend on it goes inevitably for basic maintenance.

A third type of efficiency in restructuring has to do with imposing greater logic on the integration of service missions and inducing our very spirited separated services to cooperate better with one another in performing major military missions.

It is obvious in recent times, for example, that the Navy is eagerly preparing to fight a war all by itself and has not, in fact, considered how it would contribute to the overall purpose of defending Western Europe and deterring a nuclear war. And in the course of developing an independent capability, the Navy has surged particularly its surface fleet beyond what can be sustained, and that clearly will have to be adjusted.

Similarly, we have underinvested in close air support relative to its importance and overinvested in deep interdiction relative to its importance in contributing to basic missions, and that eventually will have to be adjusted.

We are underinvesting in the equipping and training of reserve forces, given their importance, and other items such as command integration and basic lift capability.

On the excess side, we clearly have more strategic deterrence than strictly required, and several other mission categories could be constrained in order to focus money where it is more needed. That kind of reform has been difficult for us to achieve in the past, but under these circumstances we will have to take it a good bit more seriously.

Fourth, it is clear that at least in principle, the logic that is emerging in Soviet policy does provide the opportunity for restructuring the threat and making it much less demanding.

The Soviets are talking about reductions in both conventional and strategic forces in the context of comprehensive arrangements that would make the threat a good bit more manageable, a good bit more predictable, and would enable us to regulate the pace at which it evolves.

We do not know as yet whether it would be possible to formalize this new change in Soviet policy and to implement it systematically, but we certainly ought to consider that. In particular, we should pursue both the prospect of strategic force reductions and also conventional force stabilization measures that would present us with a much more predictable and more moderate threat.

Finally, and associated with that, there are underlying assumptions in our defense preparation that need examination, particularly ones associated with the criteria against which we judge our conventional forces. We have long imagined that they would face multiple contingencies, that they might have to fight in central Europe and elsewhere in the world as well at the same time, and that such fighting might be of substantial duration. We imagined that we would have to prepare to sustain fighting on this scale for time required to mobilize our economy.

If we were to make a more realistic assessment of what the Soviets are really able to do and were to be more careful about the assumptions which we apply, the judgment is very likely to be that the Soviets, like we, are not prepared to fight more than one place at the same time, and that, like we, they are not prepared to sustain the initial phase very long. If we would recognize these facts, we could be much more efficient in our actual defense preparation. The fiscal pressure on the defense budget will ultimately require us to be much more careful about these planning assumptions, much more sophisticated about those that we use.

The bottom line of all this is that our economic position in the world is of paramount importance and requires an adjustment in our economy. That adjustment will put downward pressures on the defense budget whether we like it or not. We can use this opportunity to restructure the budget and our overall security policy to very good advantage, and if we do that well, we can come out with better security at the end. At any rate, we are going to have to do it, whether we do it well or not.

I believe that in some manner all of these measures of what I have called structural readjustment will have to be carefully examined and developed. The defense budget will likely be reduced on the order to $200 to $300 billion against the current plan.

Being more efficient about the way we allocate defense expenditure and being more intelligent about the overall structure of our security are compelling purposes for this committee over the next 5 years.

Thank you.

Chairman CHILES. Thank you, sir.

[The prepared statement of Dr. Steinbruner follows:]

STATEMENT
TO THE SENATE COMMITTEE ON BUDGET

by

John D. Steinbruner

The Brookings Institution

March 18, 1988

I am pleased and honored to be able to contribute to the Senate Budget Committee's consideration of the defense budget. As is customary, I do so as an individual rather than as a representative of the Brookings Institution or any other organization. I will attempt to provide perspectives, however, that in my opinion do reflect the judgments of a significant portion of the professional community.

The burden of my testimony is that we have arrived at a moment of transition in United States security policy. The changes in the nature of international relationships that have accumulated over recent decades are powerful enough to force adjustments in the American defense posture worthy of the phrase "structural reform." Let me review the changes that have occurred, the restructuring of the defense effort that appears to be required, and some of the consequences for the defense budget that can be expected.

CHANGES IN INTERNATIONAL SECURITY

The conditions of international security are being significantly altered by three basic trends that have accumulated over recent decades: the internationalization of economic activity; the technical and operational maturation of the two opposing military establishments, and the shift in the internal policy of other major countries, particularly the Soviet Union. The United States defense budget and the planning assumptions on which it is based has not yet adjusted to these developments, and that is perhaps its most fundamental problem. The combination of these circumstances is too compelling to be indefinitely ignored or deflected. The size, the internal resource allocation and the organizing logic of the United States defense effort will eventually be very strongly affected.

This committee has already heard testimony on the decline in the size of the U.S. economy relative to the rest of the world and that is indeed an obvious fact. In 1945 we produced half of the total world product. By 1985 we produced less than a quarter of a world product that was roughly five times greater. Some reduction in the leverage and authority that automatically accrues from being relatively large has undoubtedly occurred. This development, however, has irretrievably diluted the significance of any national economy, not only because of the stark figures on relative size but even more because of the increased interpenetration of economic activity. We are not being replaced by a national rival but rather by the ascendancy of global relationships.

The true significance of this development for security is not that it has constrained the economic base for military power but rather that it has altered national objectives for most major governments. Economic performance has become the dominant concern, and that concern neither requires nor in fact tolerates the projection of military power to control territory not already possessed. Military forces are important to establish order and to defend existing jurisdictions, but they represent the necessary foundation rather than the cutting edge of international influence. Basically the projection of military power to territory that is not legitimately possessed is widely considered, for very solid reasons, to be unnecessary, unproductive, dangerous and infeasibly costly--a profound change from 1945.

This observation is not solely a philosophical or historical abstraction. It has very practical effect in immediate circumstances because the United States economy is not in stable balance with international economic conditions. The fiscal and trade deficits cannot both be sustained, and the inevitable adjustment will almost certainly involve some decline in American standards of living. We could in principle devote continuously increasing resources to national defense in the midst of these circumstances but we are not destined to do so. Such a policy is too unreasonable to prevail. There are better choices, and they are bound to be discovered.

The relative maturation of the two opposing military establishments is important for two basic reasons. It has altered the circumstances of investment, and it has changed the nature of the dominant security threat. Both sides have acquired deterrent capabilities that are powerful beyond immediate question and both have conventional force positions at the principal point of engagement in central Europe that are plausibly adequate against the threats that could realistically be mounted against them. Neither side can seriously expect to make an investment in either the size or the technical configurations of its forces that would dramatically alter either circumstance for the simple reason that the opponent has the resources, technical base, probable will and feasible option to prevent any major shift in the relative balance.

The United States and the Soviet Union are therefore in the position of maintaining, but not expanding, a large establishment and both are well protected against any calculated aggression. Both, however, must worry about their ability to control the interaction of forces under crisis conditions. It is the potential volatility of these interactions among globally dispersed forces that constitutes the major threat of war and the most compelling security problem.

And if the state of the economy and the state of the military balance were somehow unconvincing by themselves, their implications are being rapidly crystallized by shifts in Soviet policy and hence in the conception of threat that we can plausibly adopt as a guide for our own defense investment. The Soviet Union is explicitly directing its priorities to domestic economic performance and is formulating an intention to end its long period of economic isolation and to integrate into the industrial world. As an integral companion to that enterprise they are advancing a substantially altered conception of security involving major reductions in both nuclear and conventional weapons deployments. An avowed purpose is to stabilize deterrent capabilities at lower force levels with the preemptive strike threat that each side currently poses to the other significantly constrained in the process of reduction. An additional stated purpose is to transpose the conventional balance into a state in which each side has a secure defensive position but does not have the capacity to engage in offensive operations on the opponent's territory.

The Soviets acknowledge that this latter conception requires a fundamental shift in their own military doctrine, and they are authoritatively proclaiming such a shift. They also acknowledge that its implementation would involve a disproportionate reduction in their own forces, and they propose to negotiate over such an arrangement. We are bound to be cautious and skeptical about the sincerity of these declarations and about the degree to which they will be implemented. We cannot responsibly ignore, however, the obvious opportunity for improving our own security and for relieving the burdens of our own defense investment by means of agreements that would formalize and enforce those stated intentions.

RESTRUCTURING SECURITY

Realistically the necessary adjustment to these changes in the conditions of international security is not likely to occur in one of Mr. Shakespeare's "fell swoops." We appear to be at the closing of an historical era and the opening of a new one and it will undoubtedly take time to fathom the implications--probably more than one budget cycle, one election or one governmental transition. It is not too soon to acknowledge the impending necessity, however, or to begin the difficult process of altering well-established habits of thought and deeply entrenched political commitments. We will be encouraged in that by fiscal pressures that definitely command immediate attention.

As you are all well aware, the United States defense budget experienced a surge in growth averaging nearly 8 percent annually in real terms from fiscal years 1981 through 1985, and planning projections are still being affected by the momentum that was created. Though there have been declines averaging nearly 3 percent annually in subsequent years, the five-year defense plan continued to be drafted on the assumption that substantial annual growth would resume. That assumption has created a collision between fiscal realities and official planning expectations that will now require that something on the order of $250 billion be removed from the five-year plan even if the current level of defense authorization should be maintained in real terms. The necessary reduction will be approximately $350 billion over five years if the budget should continue to decrease for that period at the rate it has in the past two years.

Any outcome in this range will bring unusually strong pressure to bear on the current pattern of resource allocation within the defense budget and it is prudent to assume that squeezing at the margin while attempting to preserve all existing activities and their relative claim on resources will not produce a sufficient result. In the context of emerging international circumstances, fiscal pressures certainly motivate and may well force a structural reform of the United States defense posture. It is important to consider wh t that idea might imply.

A structural reform could be designed to preserve our traditional international commitments under a traditional conception of threat in which case some very demanding reallocations would have to be made in the pattern of defense expenditure. Alternatively, a restructuring could be designed to lessen the threat by imposing agreed regulation on the size, technology, and operational practices of military forces. At the extreme, such measures can be treated as substitutes for each other; and rhetoric aside, the United States has largely acted as if they were. Obviously, however, both approaches should in principle be judiciously combined to allow us to preserve our international commitments more efficiently. Moreover, such efficiency should be very seriously pursued before we contemplate any retrenchment of these commitments.

With all that in mind, let me suggest five basic provisions that I believe are logical, even compelling elements of a necessary restructuring of the United States security posture.

1. Optimizing the pace of weapons replacement. The rapid growth of the defense budget from 1981 through 1985 was disproportionately directed to weapons procurement, in effect increasing the rate at which U.S. military equipment was scheduled for replacement. In contrast to the early 1970s when overall weapons procurement fell below the rate required to replace equipment at the end of its efficient service life (that is, when maintenance, repair, and technical upgrading become more expensive than replacement), weapons

procurement in the 1980s has substantially exceeded this basic replacement rate. Moreover, the surge of the 1980s has exceeded the shortfall of the 1970s so that the overall rate of replacement has been more rapid than that required to match standard weapons life cycles.

There are some very serious unacknowledged inefficiencies that result from this practice. For most of the specific weapons involved, it is not compatible with the very demanding process of developing technical designs that can be effectively integrated into military operations. There is now a great deal of practical experience indicating that new weapon designs cannot be mastered at the rate required to support accelerated replacement. In particular, it turns out that extremely important design adjustments are nearly always necessary after a new weapon has first been produced and after substantial operational experience has accumulated. When we attempt to capture economies of scale with the first production runs, as has been nearly an obsession in recent years, the real effect is that we produce faulty designs in large numbers, thus either forcing military users to tolerate the consequences for their operations, or requiring retrofit programs whose costs swamp whatever initial economies of production were actually achieved. The Sidewinder missile, currently a very effective air-to-air missile, has evolved from a 1950s design and there were episodes in the course of this evolution during which its performance was very poor indeed. Similarly, the F-111, currently an effective tactical aircraft, evolved from initial designs that had some very debilitating problems. A great deal of money was wasted in large, early production runs of these before their designs were fully evolved. We should have learned the lesson, but the handling of B-1 and AMRAAM suggests that we have not.

Moreover, quite apart from the availability of fully evolved weapons designs, it is not desirable to produce more rapidly than the basic replacement for several other reasons. The U.S. leads in most of the major weapons, and the Soviet Union as well as other potential opponents learn a great deal from the models we produce. Even if we were capable of doing it, cycling new weapons designs more rapidly would have the effect of pulling the opposition along more rapidly as well. Beyond that, surging weapons production produces a surge in weapons retirement at the end of their life cycle and thus plagues defense planning decades into the future. Pacing weapons procurement to an efficient rate of replacement is an obvious, probably inevitable structural reform.

2. Stabilizing the defense industrial base. A second important structural reform, that is probably necessary to achieve the first, is to disentangle the process of designing and producing weapons from that of investing in the industries that conduct these activities. We have long maintained the cherished illusion that these industries emanated naturally from the private sector of the American economy and that the government could contract for their services and enjoy the benefits of competition among them without also guaranteeing their

basic existence. There is some part of the American economy, largely subcontractors on weapons programs, for whom this assumption holds reasonably well. For the major weapons system producers, however, that assumption is an ideological fiction and a luxury we can ill afford. Part of the reason why weapons procurement rates have surged to uneconomic levels is that procurement provides a necessary means for financing investment in the industry.

As Secretary of Defense Carlucci has suggested in his recent testimony to this committee, it is appropriate, necessary, and inevitable for the government to provide a substantial part of the investment required to sustain the core defense industry. That function could be performed more efficiently and more effectively if we would recognize it and pay the bill directly, rather than hiding it in weapons procurement contracts. That would enable investment to be structured so that it stabilizes the employment of critical technical personnel and encourages innovations to improve production efficiency.

This reform, I should hasten to add, would still subject the core defense industry to the discipline of market pressures since the government would not provide the total investment required. As occurs now, private capital would have to be competitively attracted and thus the market discipline that is currently bringing about a highly desirable consolidation of the industry, would be continued. As we all know, it is unlikely that the government could set the appropriate size and structure of the industry without the operation of market forces but it is equally unlikely that market forces by themselves will sustain the necessary investment.

3. Strategic integration of individual service missions. The individual services are a very important instance of the general principle in the American democracy of dividing power so as to preserve checks and balances. Their spirited rivalries do produce inefficiencies in our overall security posture, however, that we can reasonably aspire to adjust, if not eliminate. Each service has a very strong tendency to plan for military engagement with their own assets and to discount the potential contribution of other services. The same tendency arises among separate components of the same service as well. Some glaring anomalies result from this in the planning and allocation of the defense budget that are prime candidates for reform anytime the United States as a whole decides to be serious about improving the efficiency of its security posture.

The Navy, for example, has recently been particularly eager to explain how it can be the prime instrument in conducting and winning global war. It has budgeted an increase, particularly in its surface fleets, in pursuit of that. To any common-sense observer outside the Navy it is obvious that that is neither a desirable nor a feasible scheme. The purchase of fifteen full carrier battle groups would not enable the Navy to carry out this conception, largely because of Soviet land-based aircraft. Moreover, it is not necessary to prepare such an operation in order to prevent a global war, which is the primary objective. The peacetime and lesser contingency responsibilities of the Navy can be upheld with twelve carrier groups, and that number would also be sufficient for the truly critical naval missions in a major conventional war--the protection of sea-lanes to Western Europe. Given that ship retirement rates will double after 1992 as compared with what they have been during the 1980s, and that there will therefore be severe pressures on the ship-building budget, it is probably inevitable that the Navy reduces its surface fleet aspirations even if it does persist in maintaining fifteen carriers.

There are similar problems with the other services. The Air Force in its zeal for deep interdiction and air superiority missions has chronically neglected close air support which nonetheless provides the most effective contributions to the dominant objective of protecting forward positions in central Europe. The Army has neglected the financing of equipment and training for reserve forces even though it has drifted under the pressure of manpower constraints into increasing reliance on reserve forces for any major engagement in central Europe. The Navy and the Air Force have both neglected their long-range equipment transport services, despite the essential role they would play, again, in supporting the defense of central Europe.

Though it is true that there are many imaginable situations throughout the world that might levy significant demands on U.S. forces, the preservation of a significant barrier against invasion in central Europe inevitably remains the critical strategic objective, because central Europe is the keystone of global security for both alliance systems. If that situation is stabilized every other contingency is thereby rendered much less demanding. If we choose to do so, we can make our defense of Western Europe more efficient by adjusting the focus and resource allocation of the individual missions that contribute to it.

4. Stabilizing force balances. It should be evident by now that the expressed logic of Soviet security outlines an opportunity for regulating the balance of nuclear and conventional weapons in a way that would reduce the inherent threat and the burden of U.S. defense preparations. Diplomacy has become an instrument of security that is potentially worth quite a lot of money and, even more, offers potential returns that could not be achieved by unilateral weapons programs.

A reduction of strategic nuclear weapons suitably designed would be a very important reform in the structure of international security. The central purpose of such an arrangement is to constrain the capacity currently available to each side to attack the opponent's strategic forces preemptively. Though that capability is not powerful enough to create a rational incentive for initiating war, it is sufficient to create underlying fears that would make crisis interactions very difficult to control, largely because each side in hedging against such an attack has prepared extremely rapid reactions. Reducing forces in a way that constrains the relative contribution of multiple warhead systems would constrain the inherent capability to conduct preemptive missions and would tailor strategic deployments to fit legitimate deterrent requirements more precisely. That would help relieve the current volatility of strategic interactions.

The obvious companion to such an arrangement would be a reduction of the conventional forces applicable to central Europe so designed to reinforce the capacity to hold territory and to deny the capacity to seize it. Though there is a great deal of conceptual complexity involved in developing an explicit, generally agreed rationale for such a result, a practical outcome is not difficult to anticipate. It would involve reductions in organized ground force units on the Warsaw Pact side to prevent the mobilization of a force with a sufficient superiority in firepower to support an effective invasion. It would also involve withdrawals of active units from forward positions to prevent an effective surprise attack. And finally, it would involve reductions and modernization constraints on tactical aircraft and other means of performing deep interdiction missions. The measures to implement such an arrangement would differ substantially between the two sides--in effect a trade between Warsaw Pact ground force units and NATO tactical air units. The effect, however, would be similar--both sides restraining their primary offensive capability in order to establish confidence in defensive missions.

5. Adjusting planning assumptions. Since we run a very thorough democracy it has been difficult for the United States to establish clear assumptions as a guide to defense planning. Many of our

carefully divided agencies and political institutions have a stake in this matter and entertain strong opinions about it. Perfectly coherent consensus has always eluded us and, formalities aside, there is no official document that, as a practical matter, is completely authoritative. Nonetheless one can speak loosely of prevailing assumptions that appear to offer the most widely accepted rationale for the many decisions that have been made in the course of developing United States military forces. Clarifying these assumptions, adjusting them to evolving international realities, and implementing them more systematically also constitutes an important, if admittedly difficult, structural reform.

It is generally agreed that the purpose of the offensive forces we call strategic, by which we generally mean long-range nuclear weapons, is to deter nuclear attack on the United States or its allies by threatening credible retaliation. An important corollary of that purpose, which enjoys less domestic consensus but is a matter of explicit agreement with our European allies, is that United States nuclear weapons will also exercise a credible deterrent threat against a conventional force invasion of Western Europe. All the nuclear weapons available in our deployed forces are assigned targets with these purposes in mind, but as yet there is no officially organized attempt to judge how many of them would actually be needed to accomplish reasonable deterrent purposes.

Any individual with a modicum of common sense and a rudimentary knowledge of the effects of nuclear weapons can readily conclude that the basic purposes of deterrence would be efficiently accomplished with far fewer weapons than are actually available and in fact are targeted. Simply for the sake of efficiency in allocating our defense resources we should attempt to judge the appropriate requirement for basic deterrence and to tailor our deployments to meet this requirement with all due consideration to the problem of assuring their survival to accomplish their missions. Though there is bound to be differing opinion about the requirement, there is little question that we could cut the current forces in half and still cover the reasonable range of that opinion. Though there would be some significant immediate costs involved in investing in improved measures of protection, over the longer run a reduced level of strategic forces would save resources.

Even more significant in achieving a more efficient defense posture would be a rationalization of planning assumptions for U.S. conventional forces which, as you well know, absorb roughly 85 percent of the defense budget. It is generally agreed that these forces in service of global security must be able to resist an attempted invasion of Western Europe, and it has been traditionally assumed that they would have to be equipped and deployed to fight elsewhere in the world at the same time. In order to derive exact requirements for forces, equipment--and thus money--from these general assumptions, it is necessary to work through a maze of assumptions about the threat that would be encountered--its level of firepower, the pace at which it could be imposed, the time over which it could be sustained, the effectiveness it would achieve in the field and many other rather imponderable matters. A great deal of money and the degree of security achieved turns on the accuracy of these assumptions. To put it mildly, we have not been very careful or very systematic in the way we have made them.

It is admittedly doubtful that even an epidemic of common sense would bring settled clarity to this subject, but short of that there is plenty of room for significant improvement. We have almost certainly exaggerated the real operational capabilities of Soviet forces and thus misallocated our resources in dealing with them. In particular, we have exaggerated their capacity and inclination to fight in separate theaters simultaneously and their capability to sustain operations. As a practical matter the contingency that would test the limits of our conventional forces would have to occur in central Europe and would test Soviet resources just as much. They, like we, would not be prepared to do anything other than hold positions elsewhere, and could not fight beyond a few weeks with existing stocks of weapons. They, like we, would have to mobilize their economy to fight a conventional war of significant duration and thus there would be a lull after the initial phase of any major engagement.

A more sophisticated and more accurate definition of the threat to our conventional forces is an important element of devising a more efficient defense posture, and would alter the pattern of expenditure. The gathering and processing of information and the overall adroitness in positioning forces and moving them about on the battlefield would very likely emerge as the dimension of capability on which the outcome most depends. Some of the long neglected missions such as close air support and sea-lift would be more difficult to ignore.

BUDGET IMPLICATIONS

As a practical matter, whatever progress might be made over the next several years in restructuring the United States security posture along the lines indicated, specific adjustments in the defense budget are likely to proceed independently under the projected fiscal pressures. The adequacy of these budget adjustments and their coherence are very likely to depend, however, on achieving some significant progress on the agenda of structural reform. The two imperatives will drive each other, for better or for worse.

If a reasonable degree of coherence in overall security planning is achieved and if it is implemented with disciplined allocational decisions in the defense budget, our security position can certainly be preserved and very likely improved, even if fiscal pressures force continued declines in defense authorizations over the next five years. Such a program would reduce currently running weapons procurement programs to minimum sustainable rates in order to move back toward a stable rate of replacement. It would continue the design but defer the production of a new generation of systems that are not necessary at the moment and whose design has almost certainly not yet been mastered--the advanced bomber, the mobile MX, the small ICBM, the advanced tactical fighter and several others. These measures could save $250 billion from the current five-year plan in procurement programs alone if we are disciplined enough to make the necessary decisions.

Even this degree of restructuring will be very difficult to achieve and the well-known political support for the mentioned programs suggests the magnitude of the task that lies before us. I close simply with the observation that that task, large as it is, cannot be ignored or wished away. The United States defense program will not unfold as it has been planned.

Chairman CHILES. Senator Sasser.

Senator SASSER. Thank you very much, Mr. Chairman.

There are a number of questions that come to mind. First, Dr. Ikle, in your written testimony—and I apologize for not getting here in time to hear all of your statement—first, you say the alliance is probably more important than ever as a result of a relative decline in American power—and I emphasize relative decline as opposed to absolute decline.

We obviously could not reasonably expect to maintain the economic and military predominance that we attained in 1945, or certainly through the decade of the 1950s. But in an era of relative decline on the part of the United States, you emphasize that the alliances that we have formed are now more important than ever because we are less in a posture to go it alone militarily than we might have been at an earlier time in this century.

You also make the point, Dr. Ikle, that with less reliance on weapons of massive destruction that would not only destroy our enemies but also destroy our allies, that we ought to see, or could reasonably expect—and I may be putting words in your mouth here—a larger contribution from our allies with regard to burdensharing.

You make the point that exercising leadership does not mean assuming a disproportionate burden of the common defense.

Now, how do you respond to the argument that some make that if we move away from relying on weapons of mass destruction, nuclear weapons, if we move away from intermediate-range missiles, for example, in Europe, or if we move in the direction of denuclearizing Europe, that our allies there will be more inclined to want to make an accommodation with the Soviets; that, in effect, we might be making Western Europe akin to Finland in its relationship with the Soviet Union? I take it you do not agree with that?

What I am getting around to is I want to see that Europeans share more in the burden of the common defense. I do not want to push them in the direction of becoming neutral, however, in the East-West struggle here.

Dr. IKLE. Senator Sasser, as I see it and as our commission sees it, we cannot continue to rely and deploy nuclear weapons, and particular not for the Atlantic alliance for Europe; that is to say, we will need nuclear weapons as a backup for our deterrent forces to increase the risk of attack, and thus help deter it, and should an attack ever occur, to dissuade the Soviets from using their nuclear weapons against our military forces, or should that attack not be contained, to respond with our nuclear forces against enemy military forces.

So in that sense, nuclear forces have to continue to play an important role, particularly in the Atlantic alliance. But what we should move away from is the thinking that the most likely attack is a massive Warsaw Pact against all NATO fronts, and that in the event of such an attack the obvious and, in a sense, the only response is an all-out nuclear strike against the Soviet Union, which would in turn bring about the destruction of our alliance.

That kind of thinking drives people away from taking seriously improvements in conventional forces, or indeed even certain improvements in tactical nuclear forces, improvements in communications, in space capabilities.

I mentioned in my opening remarks the fact that we have very inadequate space capabilities for the contingency of a conventional, on which otherwise we spend about 80 percent of our budget.

I think that in part came about because of this intellectual framework that makes people focus either on peace time or on total, mutual mass destruction, but not enough on the more plausible situations in between.

Senator **Sasser**. You make the statement:

> An adjustment in our strategy to reduce the reliance on the threat of mutual mass destruction is important, not only to enable us to surmount some possible future crisis, but it is important also today to make progress on burdensharing.

I take it that you are of the view that if we move away from overreliance on weapons of mass destruction that the reaction of our allies will be to contribute more to the common defense by way of conventional means. Is that a correct reading of what you are saying?

Dr. **Ikle**. Yes, that is essentially correct. Now, it may differ case by case, but take a country like the Republic of Korea, now moving towards democracy. They have a very, very strong conventional force, essentially now based on their own resources, as it should be. They have experienced conventional invasion. There, our posture is less reliant, at least in our doctrine, than it is in Europe on the threat of nuclear massive retaliation.

Or take a country like Sweden; it has a strong defense effort and is not covered by our nuclear guarantee in the direct sense. Turkey has large forces, is not at the central front.

So these countries that see themselves exposed, that recognize the importance of conventional forces, that are less enthralled with the idea that any war would lead to total destruction—hence, what is the point of making any conventional defense efforts—those countries by and large—granted, there are some exceptions, but by and large can make, over time, a good contribution to our common defense.

Senator **Sasser**. Well, are you excluding the countries of Western Europe?

Dr. **Ikle**. No, I would not; I would hope not to.

Senator **Sasser**. The complaint that is made, and you are very familiar with these complaints, is that our Western European allies are simply not doing as much as some believe they should be doing in the common defense, and we have heard testimony before this committee that on the basis of percentage GNP or contribution on a per capita basis that their contribution is much behind that of the United States less than half that of the United States.

My thought was along the lines of trying to find ways in which to encourage them to make more of a contribution to the common defense.

Dr. **Ikle**. Well, I think we are thinking here along the same lines, Senator, as I seem to recognize, and it is partly a process of constant education and leadership, as we mentioned earlier.

Take the case of the Spanish bases which we recently read about and experienced. For a while, the discussion out of Madrid was as if these bases only served to defend Spain; that is to say, the statements made at the time—they have since been corrected—did not regard Spain as a member of the Atlantic Alliance, which it has become part of only a few years ago.

It is important to lead our allies to the realization that we want to take Article 5 of the Atlantic Treaty seriously, and if there is an attack on Turkey, Germany, France, Britain, Spain, like the United States, have to contribute to help defend Turkey, for example.

Senator **Sasser**. Dr. Steinbruner, you indicated in your statement that it appears there is a change in principle in the thrust of Soviet policy; that they are in the process, or we are seeing the first indication that they may be making the same kind of policy changes that the Chinese made a decade ago.

You indicated that there is evidence that the Soviets are now discussing restructuring their forces, their force alignment, in a defensive arrangement as opposed to their strategy heretofore, as I understand it, had been an offensive strategy in Europe.

What evidence is there that the Soviets are now moving in the direction of restructuring their forces in a defensive arrangement in Europe?

Dr. **Steinbruner**. At this point, Senator, the evidence comes largely from their internal policy discussions, as well as their external statements. But the public statements that they make to the West are backed up by statements that they make on serious planning channels to themselves.

In the past, changes in their military doctrine have been followed over substantial periods of time by changes in the structure of their forces, in the allocation of their resources, in training exercises and in the general character of their operations. That process does take time; it can take 10 to 15 years.

The Soviet Union was a centrally planned economy and does, unlike the United States, proceed with very basic doctrinal decisions which are then systematically implemented. What this means is that we are seeing the early indications. Naturally, we are not going to be convinced until we see the full-scale implementation. In this case, however, we ought to recognize that we have some possibility for encouraging the kind of implementation of these doctrinal statements that we would like to see.

Let me also connect this situation to the previous discussion you were just having. I think that we ought to recognize that the European governments are well aware of Soviet doctrinal developments and their potential. It will not be feasible for us to lead the alliance as these developments were not relevant, or to marshal the alliance around unilateral weapons programs designed to deal with the standard conception of threat.

That is not a plausible security conception to the Europeans or, frankly, to me either and many other Americans. It will not be a feasible basis for marshaling the alliance, inducing greater burden-sharing, or any other of the things we want to accomplish.

For that reason, we must deal with the newly expressed Soviet intentions in a constructive way. It is obvious that we should test them diplomatically to see how serious they are. We should formulate proposals for stabilizing the conventional balance at lower levels and pursue them diplomatically. The security conception around which we marshal the alliance will have to have this very much at the centerpiece.

Ten years from now, we may or may not have been successful, but if we do not make a serious attempt, our leadership position in the alliance will not be in good shape, to put it mildly.

Senator SASSER. One final question. I do not want to take advantage of my colleagues here, Mr. Chairman, but is there any hard, objective evidence that the Soviets are indeed restructuring their forces along the lines of a defensive strategy as opposed to an offensive strategy?

I heard on the radio, for example, this morning or yesterday that the Secretary of Defense, Mr. Carlucci, was chastising the Soviet minister of defense on the point of continuing to build what we perceive to be exorbitant numbers of tanks which are principally offensive weapons.

Dr. STEINBRUNER. I would say that as yet there is not any very substantial hard evidence, nor would we expect there to be at this point in the proceedings.

Moreover, it is worth noting that Soviet tank production is not out of line with Soviet inventories. They have to replace theirs just as we have to replace ours, and given their inventories, their rates of production have not been excessive in the past decade or so. If you look at the age composition of Soviet tanks, you can see that they have hardly been replacing them at an exorbitant rate.

Third, I think——.

Senator SASSER. But to interrupt you just a moment, Dr. Steinbruner, these tanks were produced in pursuit—I do not mean to be argumentative, but they were produced originally and they are being replaced in execution of an offensive strategy.

Dr. STEINBRUNER. At the moment, that is correct, despite the articulation of a change of strategy at the top, the effective operational strategy remains as it has traditionally been. The traditional operational configuration of Soviet forces has been offensive in character, poised in the case of war, which they say they want to prevent, to attack forward, to seize and hold Western Europe. The configuration of tanks has been designed accordingly.

I believe many people looking at this now recognize that, tanks are not quite as important as self-propelled artillery pieces in determining the relative balance of offensive and defensive operations. There is a great deal of interest in constraining self-propelled artillery and its positioning.

An army in a defensive configuration would have its artillery in different places than one preparing for an offensive. In particular a defensively configured army would have its ammunition in different places, less forward and more in rear positions.

There are many details that we can use to specify what our hard evidence would be, but it is clear in general that they have not yet implemented their new strategy in terms of these details. It is also clear that our own policy may have some effect on whether and the degree to which they do implement it.

Therefore, we want to marshal the NATO alliance around our leadership reflecting emerging international economic conditions and security conditions, it will be necessary to devise a policy that would encourage, induce, and diplomatically arrange the Soviets to complete their announced transition. Such an outcome would be of strong interest to Western Europe and to ourselves, and we simply cannot ignore the possibility. We must try to bring it about.

Senator Sasser. Thank you.

Chairman Chiles. Senator Grassley.

Senator Grassley. Thank you, Mr. Chairman.

My first question would be for Dr. Steinbruner. I would like to have you comment on how realistic you think it is, given our resource constraints, to pursue a policy of discriminate deterrence in which we seek to stimulate innovative, progressive, and leading-edge research, all of which will lead to the supposed smart weapons.

Dr. Steinbruner. It is economically and technically feasible to do this, but strategically there are very sharp limits to how far we can go in this regard. One thing I would note is that despite some rhetoric to the contrary, our basic deterrent capability is not at the moment indiscriminate. We have a wide range of capacity, which includes the ability to attack or respond to very precisely defined targets. Now, there are weapons technologies that, if pursued over a very long period of time, could, in principle, very materially improve our ability to do this, and indeed would increasingly confer that capacity on conventional weapons at long range.

But I think any commonsense assessment of the situation would lead one to conclude that there will be inevitably very sharp limits to how far either side can go in this regard.

If either side allowed the other to acquire a very elaborate force of conventional weapons with very precise targeting capability and all the infrastructure of information support required to identify the targets, you would thereby confer a very intrusive preemptive capability on conventional forces, and neither side will tolerate that.

These kinds of weapons are susceptible to counter-measures, using the same kinds of technologies. We could drive a vigorous offensive-defensive interaction involving these weapons, and will. Eventually there will have to be some degree of mutual regulation. That is the only feasible outcome.

Neither side will tolerate the other's acquiring an intrusive, preemptive conventional capability against its military infrastructure deep into its own territory.

Senator Grassley. As you have pointed out so many times, you know, in regard to the international environment changing from bipolar to multipolar, and particularly where China and Japan are concerned and where they are going to, you know, probably in the process assume leadership roles—at least their economy dictates that capability.

In your view, should NATO's role evolve from maintaining a strict military balance to one of seeking military responsiveness and assertiveness?

Dr. Steinbruner. I am not quite sure I understand what you mean by military responsiveness and assertiveness.

Senator Grassley. Well, whether our role ought to be as aggressive as it has been in the past of NATO being out in front.

Dr. Steinbruner. I think that the inexorable, evolving logic of NATO's position is to stabilize its military posture in a more defensive configuration than it now is and to induce the Soviet Union to do the same thing. This requires reducing strategic forces to a level much nearer what I have been calling the efficient deterrent requirement. That is, the ability to cover those targets we really need to cover in order to deter any calculated attack. It also requires that conventional forces be reduced and reconfigured in such a way that they reliably hold current territory but do not have impressive offensive capability against the opponent's territory or forces.

These changes would make NATO's security position defensive in character. It would improve confidence in this defensive mission, but it certainly would not change the character of the mission into a more assertive, forward-looking offensive mission. I do not think it is feasible or desirable for NATO to adopt an offensive posture.

Senator **GRASSLEY**. Dr. Ikle, assuming that the United States undergoes a strategic shift, as described in discriminate deterrence, how can the United States encourage alliance burdensharing without sacrificing military preparedness?

Obviously, this is central to most of the debate going on in the presidential campaign, except maybe by one or two of the candidates. I do not want you to necessarily speak on the presidential campaign, but obviously burdensharing is used by almost everybody running for President.

Dr. **IKLE**. Senator, we should exert constant, steady pressure to bring our allies to contribute more to the common defense. We have made some progress with Japan. Japan, of course, has the wealth and the economy to do much more.

It does not all have to be precisely in the military area. They can contribute in what we call the security assistance area. They have given a lot of aid, as you know, to the Philippines, for example, which is in our interest. They can do more there.

The allies contribute a lot in terms of reserve forces, particularly the Germans, but we have to exercise constant pressure and, at the same time, have a vision of what defense is about that makes it meaningful to exert these efforts. It makes it meaningful to have reserves, as Dr. Steinbruner recommends, and I fully agree with that.

It makes it meaningful to have conventional capabilities for defense, and to that end the main thrust of what we are saying in discriminate deterrence is that we should not bank everything on the idea that in the event of attack there will be total, mutual destruction. Hence, it does not matter whether we have more artillery, more antitank weapons, what have you; everything is gone, then, anyhow and your defenses are useless.

It is that kind of extreme thinking which is not our U.S. strategy, but has a certain role in the alliance, that can lead to a reduction in the burdensharing.

Let me, if I may, add another point on the question of defense/offense.

Senator **GRASSLEY**. Do not forget, though, my point directly related to it was not whether or not we ought to have burdensharing, which you agree with, but if we are going to be able to do that without sacrificing military preparedness.

Dr. **IKLE**. Our own U.S. preparedness?

Senator **Grassley**. Well, our burdensharing is going to demand that in a collective security approach, you know, other countries, particularly Europe and Japan, are going to pay a greater extent.

So I assume that we have to look at it in the context of all the countries involved, whether or not military preparedness as a total is going to be reduced if we rely to a greater extent on burdensharing.

Dr. **Ikle**. As rich allies like Japan, the Federal Republic of Germany, the United Kingdom, and others make more of a contribution or continue to make their main contribution, the overall total strength of the alliance will be greater, even if we have to curb our defense spending, or at least if we cannot let it increase.

People talk about reducing our defense spending. Whether we reduce it or keep it level, as other allies contribute more, this will make our total capability larger, provided we also work on having common systems and having an integrated strategy that meshes.

Senator **Grassley**. I would like to refer to some of Dr. Steinbruner's testimony, and I hope I interpret it right. I suppose if I do not, Dr. Steinbruner will come in, but I am asking Dr. Ikle to comment.

As your testimony says, in effect, if we cut the defense budget by 3 percent annually over the next 5 years, we could still have a reasonable degree of overall security planning. We might also have disciplined allocational decisions, and we can actually improve our security position. And we can have all this, despite, as he acknowledges, a hugh underfunding problem.

In your view, from your standpoint in the years you were in the Defense Department—you were right in the middle of all this—is this your reaction? Do you see this as realistic or do you see it as being some kind of posture of voodoo defense?

Dr. **Ikle**. I would think this is too much of a gamble, too much of a building on hope that the evolution of Soviet foreign policy is in the direction of a benign attitude towards their neighbors, a retrenchment, in essence, from what we have seen in past decades.

It takes too much of a risk that we may encounter again what we did, for example, after World War II when we did a massive retrenchment and cut-back in our overwhelmingly strong forces, and we were rewarded for doing that by all the offensives that Stalin's Russia then initiated in Korea, in Europe, and in Czechoslovakia, and that has been very costly for us ever since.

So I would not want to take this gamble. I would proceed at a more steady pace. Also, we have to get away from the thinking of symmetry between East and West. We talk too glibly about defensive Warsaw Pact and defensive NATO.

Obviously, we want to have a mutually stable situation eventually, and we should explore, I agree with Dr. Steinbruner, these arms control suggestions from Moscow. But the idea that NATO should ever be seen by Moscow as being offensive, Senator, is utter rubbish.

The Soviets are fully intelligent enough to know what goes on in Brussels. They know the alliance cannot even take a decision to mobilize its own forces when they invade Czechoslovakia or they do something in Hungary. The alliance is totally incapable of waging offensive war and making a decision toward preparing for it, and the Soviets know that full well.

Dr. **Steinbruner**. Senator, let me correct your impression what I was trying to say. I was not advocating as a matter of policy a 3-percent decline in the defense budget. What I was saying is that our position in the world depends upon bringing our economy more in line with international economic conditions. In the course of that there will necessarily be a difficult domestic economic adjustment, very likely to force a downward drift in defense budgets.

That circumstance is going to force upon us much more serious efforts at internal efficiency in the defense budget than we have had to make or have made in the last decade, and I was outlining what they would be and noting that at the same time there does appear to be an opportunity for relieving the burden of the threat by negotiated means.

It is the simultaneous handling of all these pressures that I was trying to depict.

Senator **Grassley**. My last question, Dr. Ikle, is, again, in this report on discriminate deterrence it mentions that new kinds of planning and equipment are necessary for low-intensity conflict.

Before I get to my bottom-line question, though, are we talking about new technologies here or are we talking about off-the-shelf, less complex systems?

Dr. **Ikle**. On the low-intensity conflict needs, we are talking essentially about off-the-shelf things, not very expensive things in terms of the overall defense budget.

Senator **Grassley**. Okay. Well, then, is it not a valid observation that we put too much emphasis on technology as the solution to our problems, and that relying on too much technology eventually leads to complex systems, cost overruns, scaled-down productions, and less defense for the dollars? That describes the pattern for the last several years.

Dr. **Ikle**. It is sometimes true that we get things too advanced, too delicate, too difficult to maintain, too costly per unit, and we also stress the importance of working on the accessories, the tactical missiles that go on ships, not just the platforms, the accurate missiles that go in aircraft that make an expensive aircraft more efficient.

These are the cheaper items, less expensive than the large systems where we can use advanced technology more effectively. So it is a matter of striking the right balance. We do not want to forego advances in technology, such as the low-observable, the stealth technology, which, if properly applied and tailored to new missions, can really make a great deal of difference for us.

Senator **Grassley**. Senator Sasser, I am done. Thank you both.

Senator **Sasser**. Thank you.

Gentlemen, there seems to be a difference of opinion here. I would like to get both of your views on it. I get the impression, Dr. Ikle, that the commission that you headed seems to believe that in the future both China and Japan will become substantial military powers in their own right. Dr. Steinbruner, I do not think, agrees with that.

I would like to explore the logic that leads you to your differing conclusion. Would you want to go first, Dr. Ikle?

Dr. **Ikle**. Senator, China more likely is going to be a major military power 20 years hence, and that is based on the projection of its economic growth which we project to be more rapid than that of the Soviet Union, the Soviet Union, we project, being rather stagnant. Now, all these projections and economic forecasts, as we know, can be off the mark.

Japan, of course, has had dramatic economic growth, but for its own traditional historic and political reasons has curbed its defense spending. So, there, we have a major uncertainty.

If Japanese defense spending should go up to the level, say, of Great Britain, 4 percent of gross national product, or France, you would have a very massive, almost a fourfold increase in Japanese military strength over a 10-year period.

That in itself could have major repercussions in the relationship of these powers, China-Japan, Japan-South Korea, Japan-ASEAN countries, and could possibly lead to some instability in diplomatic relations.

So what we face here is considerable uncertainty and a very important question; that is to say, the extent to which the United States can maintain a close alliance with Japan, which I think is of overarching importance, given the technological and economic prowess and the democracy that exists in Japan, and a good strategic relationship with China.

If we can do that and keep our Atlantic alliance, we have what I would like to call a commonwealth of democratic nations that would have nothing to fear.

Senator **Sasser**. You know, I am one who believes that history is the best guide to the future, and I am curious as to why you would think that China would be more likely to grow into a military power than Japan.

Historically, China has been rather benign militarily from recorded history onward, whereas at least in the last 100 years, and perhaps before that, Japan has had a military culture and been very aggressive militarily up until the end of the Second World War.

Why would China become suddenly more likely to become a military power than Japan? I am not sure I follow that.

Dr. **Ikle**. Senator, I do not want to dispute you on this. There is nothing firm and hard about these forecasts. Presently, of course, China does have a large military force; it has been slow in modernizing it, but there is a certain recent tradition.

You are quite right. The more recent tradition is different, so I would not dispute with you that there is a great deal of uncertainty. All the more important to keep our attention on these future giants in Asia.

Senator **Sasser**. What do you say about it, Dr. Steinbruner?

Dr. **Steinbruner**. I would say that the conception of China and Japan emerging as military powers, in the sense of projecting regional or global military power, simply misses the logic of what is happening in either of these countries or in Asia generally.

We probably will see vigorous economic development, or at any rate there is a distinct possibility that we will in China, but this is occurring in a context of policy in which the projection of military power is not a driving purpose and would interfere with the very development of economic capacity referred to.

It is clear that what we are seeing in Asia is a laboratory for the emergence of new kinds of political and economic relationships in which international economic interaction is given priority and the very violent history of nationalist sentiment is subordinated in order to protect that. Military force is given very strict defensive purposes and subordinate position.

If you take the recent past as a clue to the future, that is the kind of pattern I would project for that region. I think we have a lot to learn from that pattern. There is a lot that is constructive in it, and it certainly does not suggest the development of this standard conception of threat. That just is not what is going on out there.

I would conclude that it is not feasible or desirable for us to focus our policy on the very remote, highly abstract, and very unlikely possibility that China and/or Japan would emerge as standard military powers directly threatening to the United States or our other regional allies. It is important for us to focus our policy on the emerging opportunity that this new pattern of relationships in Asia provides. The Asian world subordinates military power to defensive purposes and makes economic interaction the driving focus of national policy. I think that is the clue that we should take from this region.

Senator SASSER. Dr. Steinbruner, you indicated that we should be investing more of our defense budget in training reserve forces and getting them up to a higher state of readiness.

What do you say to those who argue that if there is another war that we will not have time to mobilize reserves and bring them into play, so to allocate a lot of resources would be wasteful?

Dr. STEINBRUNER. This is admittedly a very complicated and extended argument, Senator, but let me briefly summarize it. First, we are drifting inevitably toward greater reliance on reserves because of our underlying manpower situation. The changes I referred to would systematize that.

Second, the development of a major war is not something that should so surprise us that we are unable to detect it or to prepare for appropriate mobilization. Given our dramatically improved intelligence capabilities, it would simply be irresponsible for us to be surprised to that degree.

Clearly, we should improve the process whereby we equip and actually prepare to mobilize these reserves. In addition, there is the possibility of reducing and reconfiguring forces by diplomatic agreement so as to reduce the weight of Soviet mobilization and to achieve a redeployment of Soviet forces backward from forward positions that would give us more time in which to mobilize our forces if we had to. These measures would give us much greater capability to stalemate any Soviet attack.

Under these conditions, reliance upon reserves would be much more feasible. These two measures go hand-in-hand, if you will, to produce an overall, integrated posture. I think that posture is thoroughly feasible. There would be some very great domestic political difficulties, though.

Senator SASSER. Do you want to add to that, Dr. Ikle?

Dr. IKLE. Just one little cautionary footnote here. Deploying back from one front may be deploying forward to another front. We have to watch out, as we talk about deploying backwards Soviet forces in central Europe, that we do not increase the threat to the Persian Gulf region by their redeployment towards that area.

Dr. STEINBRUNER. I think that is a good point, but presumably the stabilization measures I referred would involve both reductions on the Soviet side as well as redeployment, and the net result would give them a less ready capability in all of the forward theaters.

Chairman CHILES. Well, you both agree that one of the unanswered questions now as to what kind of changes we are really going to see in this Soviet movement is what happens whether there is some real meaningful reduction in conventional forces?

Dr. IKLE. Yes, Mr. Chairman, and there is an interaction here between what we do and what happens in Moscow. On the one hand, we want to be responsive to favorable developments from our point of view.

On the other hand, we do not want to give a new temptation to expansionist thinking in Moscow. To revert again to the historic example, I think we tempted Stalin too much by our rapid demobilization and cutbacks in 1945–46. Again, more recently in the 1970's, we tempted Brezhnev too much. We should not repeat that kind of mistake.

Dr. STEINBRUNER. I certainly do not disagree with that, but I do not think there is any danger of repeating that mistake, nor do I think that we are in anything like that same situation.

At the moment, the principal problem is simply formulating the United States and NATO position that defines a plausible outcome and using that, then, to test the seriousness of the Soviet diplomatic position.

They have stated propositions that appear on the surface to be interesting, most notably the prospect of asymmetric reductions; and we have not countered with a proposal as yet that would provide the basis for testing their sincerity.

It is difficult to develop such a proposal in a democratic alliance, and that is the process in which we are enmeshed at the moment. But it is quite important and urgent that we do so in order to see whether the Soviets are willing to back up their statements with something concrete along the lines that we would agree to. We have not yet given them a proposition that tests that.

Chairman CHILES. I agree, I think, with both your statements, and I think we do have to certainly be prepared to come forward with a test. It seems to be that we always sort of hear what we like to hear and we always want to assume that everybody is going to do the right thing and that they mean what they say, especially if they say something.

Thus far, would you agree that the moves that the Soviets have agreed to in regard to the intermediate treaty and even what has been talked about in START are fine, but they strictly work for the Soviets and for their strategy and still does not tell us ultimately whether they are really ready to reduce some of the tensions, and that that test has to be in conventional forces?

Dr. **Steinbruner**. Certainly. I think that we have not yet had the definitive test, but constructive intentions are certainly plausible. Such intentions are consistent with their own interests.

Chairman **Chiles**. I think so.

Dr. **Steinbruner**. Reducing their own security burden is important to them as well.

Chairman **Chiles**. I think so, but I agree with Dr. Ikle. I think we have to be careful that we do not start changing our strategy so drastically and taking steps until we see what happens in this next era.

In fact, if we are going to support the intermediate treaty, we have to be prepared to recognize what we need to do in the conventional area and the modernization area, and encourage our allies to do that and continue on that basis.

Dr. **Ikle**. Well, I would say, Mr. Chairman, we have to maintain the right pressure, the right combination of pressures and inducements, and one of the inducements we cannot offer is to make NATO defensive. NATO is already defensive; we cannot offer that again.

Dr. **Steinbruner**. I think that is right, but when you get down to it, the inducement we do offer in that regard has to do with the future. What the Soviets profess to be worried about—in the long term, at any rate, and with some reason—is the development of highly intrusive, deep interdiction capabilities on the NATO side. We say, of course, that such capability would only be defensive in character, which they worry about its offensive implications.

Now, that capability does not yet exist. It is all future music, but it is nonetheless the core of their concerns. They have a much inferior technical base in the pertinent technologies and they have to compete despite that. They are quite worried, I think, about the possibility that we would mobilize our technical assets to optimize deep interdiction capability. If we did so it would begin to confer an offensive character to NATO capability in the future.

In effect, the trade that we are talking about here is relief from this future threat on their side in exchange for relief of very immediate force structure threat on ours. They reduce the structure of their forces; we constrain the scale and pace of our own technical modernization. Those are the terms of trade.

It is a very complicated arrangement, but quite logical in terms of the core security interests of the two sides, and it is definitely one that we will have to explore.

Chairman **Chiles**. Dr. Ikle, you noted in your statement that the dollar we spend for security assistance is sometimes the most effective dollar we spend. Do we not see at the same time that often—I am talking now about our mix of weapons in that security assistance—we tend to give weapons that are too sophisticated to the country to be able to properly use them? Perhaps at times we also escalate the tensions in the region by giving weapons that are more threatening than they would need to be for sort of the defense in the region. I would like to have your comments on that.

Dr. **Ikle**. Yes, I think there are such cases where a certain weapon type becomes a prestige item and is very much desired by the recipient country, but I think we have made progress.

Thinking of specific cases, the kind of assistance we provided to the forces of El Salvador after Duarte particularly became president really has been practical, the kinds of things which help those forces not to advance.

The kind of assistance we have been able to get to the Turkish forces, of course, an Atlantic ally, has been of the right kind. One of the recommendations in our report, and in one of the follow-on reports, is that maybe we should loosen restrictions about using third-country military equipment for our security assistance on occasion—this is very difficult to do in the present legislation—which might make it possible sometimes to provide a simpler system.

Chairman CHILES. By using third-country capability?

Dr. IKLE. Yes; for example, by using a Spanish-designed system or a South Korean system. Now, we do not want to go very far in that direction. Obviously, we want to foster the export of our industry, and as of now, of course, all of the security dollars really come back to the United States.

Chairman CHILES. Do you have further questions?

Senator SASSER. Just one or two quick questions.

Dr. Steinbruner, you indicated in your testimony that there was evidence that the Navy was preparing to fight the next war all by itself, and some have thought that Secretary Lehman might have had that in mind at some juncture.

What makes you make that statement? What do you base that on? And, number two, do you think we ought to build two additional nuclear aircraft carriers?

Dr. STEINBRUNER. The statement was a characterization of the opinion outside the Navy of what they are trying to do with the famed maritime strategy. It was a means for explaining how the Navy could conduct an imagined war largely on its own.

It does not make much sense viewed from the point of view of overall national security in which all services are contributing to the outcome, and in which the primary purpose is to prevent the war in the first place.

The war that we are trying to prevent, first and foremost, is the threat to central Europe. The Navy's purpose was to defeat the Soviets globally and to attack forward into their bastian areas, and they simply, in advancing that notion, gave what was not a very believable rendition of how we would use the fleets that they were trying to procure.

If we wanted to attack forward with naval forces against Soviet bastian areas, we would need many more carrier task forces than there is any possibility of providing, and so there was a disconnect between the logic they were advancing and the kind of forces that even under the wildest stretch of imagination the country might provide them.

Needless to say, the articulation of this was greeted outside the official Navy circles with great skepticism. What I was saying is that we ought to bring greater logical coherence to the role of the Navy would actually play in serving our national security commitments.

What that means really is in the event of a major war, their primary mission would be to secure the supply routes to Western Europe and to make it clear to the Soviets in advance that we could do that and they could not count on isolating Western Europe by the combination of land attack and naval missions. The Navy can certainly do that with 12-carrier task forces, and the difference between 12 and 15 is insignificant with regard to that particular mission.

Moreover, one has to notice that the increase in the fleets in the 1980s were guaranteed or enabled, at any rate, by an unusually low retirement rate, given past procurement history.

The retirement rate for Navy ships will double after 1992, and under those circumstances and these budget projections, it simply will not be feasible to maintain the Navy's current aspiration for fleet size. We are going to have to adjust the fleet goals downward, and it will be difficult to keep it up under more modest goals. In the process we will have to develop much clearer logic about the purposes of the Navy, and we will have to impose the obvious discipline of supporting the overall U.S. security position and not conducting war on their own.

Senator SASSER. The bottom line is you do not think we need the two additional nuclear aircraft carriers?

Dr. STEINBRUNER. I do not think we need them, but I think we have them. What I am saying is that we do not have to procure everything that goes with a carrier task force—all the surface ships and airwings and everything else required to equip it.

As a practical matter, as I read the budget, we are likely to have 15 carriers. We do not need 15 full carrier task forces.

Senator SASSER. Do you want to comment on that, Dr. Ikle?

Dr. IKLE. Well, as a former undersecretary in OSD, of course, I agree that we need a U.S. strategy, not a Navy, Army, and Air Force strategy. But I think it would be wrong to say that the Navy systems are not making a major contribution to overall returns, to keeping open the supply lines.

What we have to keep in mind, particularly when it comes to naval and marine forces, for that matter, and also air forces, is that we have to look at contingencies other than the traditional worry about the attack on the central front, particularly in the Persian Gulf where naval forces are very vital, we have seen recently.

The certain improvement in our mobility which we achieved in the last 6 years has greatly enhanced the deterrence against an attack against the Persian Gulf, in my view a more likely contingency than an attack against Germany.

Dr. STEINBRUNER. I agree with that, but I think again, that 12-carrier task forces do cover the necessary missions under realistic assumptions.

Chairman CHILES. I think our big concern is to make sure that it is an American strategy and that we cannot—with dollars so scarce—have a situation in which each of the armed services can decide that in order to keep ourselves strong, we have to have this sort of mission.

Someone at the top has to say the mission is the mission for the country and we will fit everybody in. I think our big problem is to make sure that we are not allowing it to be driven the other way.

As we look back at the 1981 buildup, and I certainly supported that buildup, I think we needed to do it, but much of it was driven in some ways by each force saying now is the time; we have got to have tanks or carriers or we have got to do this, rather than from the top down. I think that is what we are recognizing, that we have got to have that decision come from the top on down.

We thank you very, very much for your appearance here today and your statements. It was very helpful to us and we were delighted to have you here.

Dr. **Ikle**. Thank you, Mr. Chairman.

Dr. **Steinbruner**. Thank you.

[Whereupon, at 11:30 a.m., the committee was adjourned.]

DIRECT FOREIGN INVESTMENT IN THE UNITED STATES

TUESDAY, MARCH 22, 1988

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 9:40 a.m., in room SD-608, Dirksen Senate Office Building, Hon. Lawton Chiles (chairman of the committee) presiding.

Present: Senators Chiles, Sasser, Lautenberg, Symms, and Grassley.

Staff present: Richard N. Brandon, staff director; and John Hilley, assistant director fo macro-economics, trade and finance.

For the minority: G. William Hoagland, staff director; and Gail Fosler, chief economist.

OPENING STATEMENT OF CHAIRMAN CHILES

Chairman CHILES. This morning we are going to examine the issue of foreign direct investment in the United States.

With us are Dr. Susan Tolchin, a professor at George Washington University, and coauthor of the book "Buying Into America"; and James Powell, of New Canaan, CN. We welcome you both and appreciate your willingness to be with us.

In just 4 years' time between 1982 and 1986, this country went from being the world's largest creditor nation to the world's largest debtor. It is the first time an industrialized nation has gone back into debt status in peacetime.

We have been a debtor before but under much different conditions. We borrowed as an infant nation to get started. We borrowed to join and dominate the industrial revolution. But now we borrow for everything, trying to hang on to the idea that "we can have it all," regardless of how much it costs.

Now, it is true the United States is still the world's most vibrant and diverse market. And we have attracted money because of it and because we have a stable political environment. We also get some short-range benefits when other nations invest and build in our country.

Obviously, we gain some capital and profit from foreign technology transfers. We acquire jobs and help sustain the open trading system. But what is the cost?

Aside from the fact that our borrowing habit is driving our international debt toward $1 trillion, foreign investment has raised some questions we want to examine this morning.

Take jobs, for example. The kind of plants built here by foreign investors are often assembly points. We put together products created overseas. You have to wonder if, in some sectors, we are becoming a clone of old Singapore, where Americans do the piece work, other nations reap the profit, and keep the high-skill, good-pay jobs for themselves.

Besides the quality of jobs, the lure of foreign investment has begun to pit State against State to see who can offer the most attractive break. We have seen situations where the dairy farmers of Georgia have battled the dairy farmers of Wisconsin over the business of an Irish firm.

We have seen State legislatures subjected to intensive lobbying campaigns by foreign countries to alter State tax laws. And, of course, that raises the question of how much influence and how much foreign money is working to alter the shape of American political decisions.

When foreign nations build here, they have immediate access to American technology. When foreign nations buy here—when another nation buys a ball bearing plant or a semiconductor plant—what does that mean to our national defense establishment? Certainly, when a foreign nation builds here, buys here, then sells to American adversaries, we have to ask if the price of foreign investment becomes an issue of national security.

Nobody in the world owes more money than the United States. We can say what we want about how nice it is to have foreign money in this country. But I cannot help but think of the story of "The Devil and Daniel Webster," where a trade is made for the good life now in return for hell to pay later.

This morning we want to look at the extent of foreign investment, what good it does us, what harm it might do, and what can be done to properly manage and monitor these activities.

I look forward to the testimony of our witnesses. I know there will be a good many questions.

Senator Symms.

Senator SYMMS. Thank you very much, Mr. Chairman. I would first like to ask unanimous consent to introduce into the record at this point the statement by the ranking member, Senator Domenici.

Chairman CHILES. It will be put in the record.

[The prepared statement of Senator Domenici follows:]

OPENING STATEMENT

HEARING ON FOREIGN INVESTMENT IN THE UNITED STATES

Senator Pete V. Domenici

March 22, 1988

I AM PLEASED TO JOIN THE CHAIRMAN IN WELCOMING YOU BOTH TO THE SENATE BUDGET COMMITTEE THIS MORNING. OUR OWN ECONOMY AND THE WORLD ECONOMY IS UNDERGOING ENORMOUS CHANGE. A SYMPTOM OF THAT CHANGE IS THE INCREASING AMOUNT OF FOREIGN INVESTMENT IN OUR OWN COUNTRY.

IT GOES WITHOUT SAYING THAT WE DON'T UNDERSTAND THE IMPACT OF THIS FOREIGN INVESTMENT ON ALMOST EVERY ASPECT OF OUR ECONOMIC LIFE -- BUSINESS DECISIONS, BUSINESS AND LABOR PRACTICES, EVEN POLITICS. DR. TOLCHIN. YOUR BOOK PERFORMS AN IMPORTANT SERVICE IN RAISING MANY OF THE ISSUES THAT CONCERN US.

FROM MY OWN PERSPECTIVE, I DON'T SEE THAT WE HAVE ANY OPTION BUT TO GO FORWARD AND ACCEPT THE REALITY OF FOREIGN INVESTMENT. FOR A GREAT NUMBER OF REASONS, WE HAVE RUN UP SIZABLE DEBTS, BOTH DOMESTIC AND FOREIGN.

WE SIMPLY HAVE MORE NEED FOR INVESTMENT -- WHETHER IN GOVERNMENT OR IN THE PRIVATE SECTOR -- THAN WE HAVE SAVINGS. WE HAVE TRIED ALL KINDS OF POLICIES TO GET AMERICANS SO SAVE MORE. BUT FOR SOME REASON, THEY HAVE NOT BEEN SUCCESSFUL IN RAISING THE NATIONAL SAVINGS RATE.

THE JAPANESE SAVINGS RATE IS OVER TWICE THAT OF THE MOST GENEROUS MEASURE OF THE U.S. RATE. NOW, IT IS ALSO TRUE THAT THEIR INVESTMENT RATE HAS FALLEN DRAMATICALLY IN RECENT YEARS, SO

THEY HAVE TO DEPEND ON US TO PROVIDE A GOOD RETURN ON THEIR INVESTMENT.

THIS INVESTMENT BARGAIN IS CLEARLY A TWO WAY STREET. IT BENEFITS US; BUT IT ALSO PROVIDES IMPORTANT BENEFITS TO FOREIGNERS WHO FIND FEW ATTRACTIVE INVESTMENT OPPORTUNITIES IN DEVELOPED COUNTRIES OTHER THAN THE U.S.. IN SHORT, FOREIGN INVESTMENT WILL BE AN IMPORTANT FORCE IN OUR ECONOMIC LANDSCAPE FOR SOMETIME TO COME.

MY OWN STATE OF NEW MEXICO NEEDS TO DIVERSIFY ITS ECONOMIC BASE TO REDUCE ITS DEPENDENCE ON COMMODITY-BASED INDUSTRIES. NEW MEXICO NEEDS INVESTMENT CAPITAL TO DO THAT. NEW MEXICO MAY VERY WELL NEED FOREIGN INVESTMENT CAPITAL.

ACTUALLY, THE PROBLEM THAT REALLY CONCERNS ME ISN'T OUR OPENNESS TO FOREIGN INVESTMENT BUT THE CLOSED DOOR AMERICAN INVESTORS OFTEN FACE IN OTHER COUNTRIES. I AM CONCERNED, FOR EXAMPLE, THAT THE PROPOSED U.S.- CANADA FREE TRADE AGREEMENT RESTRICTS U.S. INTERESTS TO MINORITY OWNERSHIP IN CERTAIN ENERGY DEVELOPMENT PROJECTS IN CANADA WHILE CANADIANS CAN INVEST FREELY HERE.

THIS MAY BE MORE OF A SYMBOLIC LIMITATION THAN REAL. STILL, IT CLEARLY SENDS THE WRONG SIGNAL IF THE GOAL OF SUCH AGREEMENTS IS OPENNESS AND THE FREE FLOW OF GOODS AND CAPITAL.

WE ARE GOING TO BE STRUGGLING WITH THE DOUBLE-EDGED SWORD OF FOREIGN INVESTMENT MORE AND MORE FREQUENTLY HERE IN CONGRESS. I WELCOME THE WITNESSES HERE THIS MORNING AND LOOK FORWARD TO THEIR TESTIMONY.

Senator **Symms**. Then, Mr. Chairman, I would just say that I welcome our two witnesses. This is a subject I have been very interested in for many years, foreign investment and the impact it has on our economy. From checking with some of my constituents and other friends around the country, Mr. Chairman, I would have to say that people generally fall into two categories on this: those who are sellers are all in favor of foreign investment, and those who are buyers are not so sure they favor it.

I look forward to hearing the witnesses, and then I will have some questions to ask. Doctor, we welcome you here this morning, and Mr. Powell.

Chairman **Chiles**. Dr. Tolchin, we will start with you.

STATEMENT OF DR. SUSAN TOLCHIN, PROFESSOR OF PUBLIC ADMINISTRATION, SCHOOL OF GOVERNMENT AND BUSINESS ADMINISTRATION, GEORGE WASHINGTON UNIVERSITY

Dr. **Tolchin**. It gives me great pleasure to be here this morning to testify on the subject of foreign investment. My remarks are drawn from a new book that my husband, Martin—whom some of you are familiar with, a journalist with the New York Times—and I have written called, "Buying Into America: How Foreign Money is Changing the Face of Our Nation."

When we started this book, we were inspired, actually, by a conversation with Senator Sasser who, 4 years ago, said, "A funny thing happened to me on the way to my last election. Executives from the U.S. subsidiary of Nissan Corp. were running a candidate against me, supporting that candidate, holding fund-raisers, contributing, getting workers out and so on."

This was a curious state of affairs, we thought, for a foreign multinational to be involved in a U.S. Senate election. So we started looking into the question of the politics of foreign investment, how foreign investors had penetrated the U.S. political process. We came out with the following conclusions that were rather striking to us over the 4 years in which we did our research. We traveled the Nation. We went to California, the midwest, the northeast, Middle Atlantic, and all over the South; we visited foreign plants, and we came up with a very interesting picture.

Foreign money, we feel, is changing the face of America, the lives of Americans, and the nature of our political process. In the process, I think it is also compromising American political and economic sovereignty.

The trend of buying into America is accelerating and will accelerate in the future, spurred by the drop of the dollar. The newspapers have been cooperating with our book. Every day there is another headline about a foreign buyout of a U.S. firm: Campeau's attempt to buy Federated Stores, the recent Bridgestone acquisition of Firestone's tire division, and the recent Saudi attempt to buy Texaco. A leading investment banking firm in New York has established a "bargain basement" committee for the single purpose of identifying vulnerable American assets for its foreign clients.

And you had better believe that if this investment banking firm has a bargain basement committee, the other leading banking firms, all of whom are very competitive, have established something very much like the bargain basement committee, perhaps under other names.

Foreign investment has reached an all-time high, $1.5 trillion, three-quarters of which is in Government and private securities. Foreign investors now hold between 10 and 20 percent of the Nation's $2 trillion debt, and that is rising.

Another significant factor that we have found is that 20 percent of all foreign investment is held by foreign governments as opposed to private investors. We must begin to look more closely at where the agendas of foreign governments differ from the private investor who is supposedly just anxious to make a profit.

I might say at this point that this is my fourth book. I do not know whether that is a study in masochism or anything else. But in the course of all the books I have done, this book was the most difficult to research because of the paucity of the data, the inadequacy of the data, and the difficulties in tracking foreign investment in the kinds of ways that I think foreign investment should be tracked in this country. Other countries track it much more closely than we do.

Foreign investors, we have found, are making significant inroads into such vital industries as machine tools, banking—the latest figure I just saw yesterday is that 21 percent of the Nation's banking assets are now foreign-owned—chemicals, four of the Nation's top chemical companies are foreign-owned; cement, automobiles, tires, auto parts, construction and so on. Foreign investors have bought land, skyscrapers, shopping centers in almost every State of the Union, and hold large chunks of prime downtown real estate in cities across the Nation. Twenty-five percent of downtown Washington is held by foreign investors.

In other words, foreign investment has affected the economy with an impact that is just beginning to be felt, and it has become a national issue linked to America's new status as a debtor Nation, which Senator Chiles referred to, and the Nation's deepening dependence on foreign money. We have become addicted to foreign money, and this is a position that we have to study.

No one is blaming the foreign investors. If I were a foreign investor, I would come in here and try to buy up everything that is not nailed down also because U.S. assets are now so cheap. And with the dollar low, they are going to become even cheaper. I just learned 2 days ago that foreign investors have stepped up their move to acquire more U.S. assets before the Reagan administration ends its term in office and the possibility of renewed antitrust enforcement looms on the horizon. They are accelerating their purchases; we should expect to see a substantial increase in foreign investment in the next 8 months.

Foreign investors have become key players in American politics, making their presence felt at every level of the political process. If this continues, I think the threat of losing a measure of political and economic sovereignty becomes a real possibility.

I am glad that the Senate is interested about this issue because I think there are certain questions that the Senate, and the House of Representatives, can ask and begin to investigate in order to stem this loss of American political and economic sovereignty. Some of these questions include the following: What are the effects of increased competition among the States and cities for foreign investment?

The States are engaged now in a form of economic fratricide. They compete with each other to see who can offer the most tax abatements, grants, real estate and loans, while the foreign multinationals sit back and wait for the best bargain. They are smart. I would do the same thing. Kentucky for example, has spent $125 million in incentives to lure Toyota to the State, while other States have followed suit with hundreds of millions of dollars in incentives to lure these foreign multinationals to their particular States.

You cannot blame them. The Governors and Mayor are doing their job. They want to bring jobs, technology, and economic revitalization to their States. But there is a secret that is becoming increasingly well known; that is, that these foreign multinationals will come without incentives. They want to locate in the United States to corner market share, make a profit, and avoid protectionism. These hundreds of millions of dollars are unnecessary.

In Kentucky, as I mentioned, the State spent $125 million. The newspapers down there reported the real figure as closer to $350 million.

The rush to inundate investors with incentives rests on the assumption that all foreign investment is beneficial. While much of it is beneficial, there is no question that, in effect, the United States is subsidizing the surge of foreign investment without assessing the impact on the Nation of this investment.

In other words, we can start to ask subquestions of this question. How many of these companies are going to put American businesses out of business? And if, in fact, that is so, why are we subsidizing them?

Another subquestion there is: How many of these foreign investments are already being subsidized by their own countries? I remember an interview I had with the CEO of Bridgestone's U.S. subsidiary and I said to him, "Are you borrowing your money here or back in Japan?" And he said, "Are you kidding? With a prime rate of 8 percent in Japan?"

So when you look at foreign investment from the point of view of a two-level playing field, you discover that many of these companies already come in with advantages. Why, in effect, are we subsidizing them even further?

The second question is: What is the impact of inadequate data collection? The United States is flying blind on foreign investment. At least 50 percent of foreign investment, we found, goes unreported. Lax reporting requirements, hidden ownerships and other circumventions of the law have made it virtually impossible to keep track of foreign investment. It is easy, we found out, to hide your identity by going to the Netherlands Antilles, incorporating four times, and nobody will know who owns a shopping center in their district or who owns that piece of prime real estate in downtown. Urban real estate is the hardest to track, followed by agricultural land, manufacturing, and securities.

Another area in vital need of more systematic information includes the "technology drain". Where are foreign investors investing to acquire American technology? We have seen a lot of the R&D go back to the home country once a foreign investor invests in a company. That R&D very often goes back home, and the U.S. loses the benefits of that R&D.

We have got to know more about the "money drain". Where are the profits going? Most people say it is as good to have a foreign company in this country as it is to have an American company. Well, the last figures we saw indicate that in 1985, 79 percent of the profits of foreign-owned U.S. firms were repatriated back to the foreign parent. All things being equal, I think we should question whether, in fact, it is as good to have a foreign firm here as it is to have an American firm.

"The industry drain". What industries can the Nation afford to lose? We have to ask ourselves a question: Is there an American component that should be retained in any vital industry? For example: 21 percent of the Nation's banking assets are now foreign-owned. Is there a ceiling? Should 50 percent be owned? Eighty percent? A hundred percent?

What about tire production? Bridgestone has just become the Nation's third leading tire producer. What happens when it becomes the second or the first?

"The government connection". Do foreign government investors have interests that are different from U.S. interests? There are many foreign governments that have investments here whose agendas are quite different from our own.

"The fairness issue". Where do investment barriers restrict U.S. investment? It was quite surprising to me, since I am an advocate of free trade and free investment, to see that the world is loaded with investment barriers. Some of our leading trading partners, countries with whom we have trade deficits, also have enormous investment barriers to U.S. outward investment. In Japan, for example, many high tech industries are reserved for Japanese investors alone. In some industries, U.S. investors cannot invest unless they have a majority Japanese partner.

We have a welcome mat. Why don't other countries have this welcome mat?

And, of course, another question is: What is the impact on national security? We have a chapter in our book on the Soviet purchase of four banks in California's Silicon Valley. Americans are so hungry for foreign investment that they are blinded to issues of national security and fail to take appropriate steps to monitor the source of foreign funds until it is too late. This led the late CIA director, William Casey, to term foreign investment a "Trojan horse"—friendly on the outside but carrying a threat to American security within. Casey was particularly concerned with the foreign acquisition of American technology through investment.

What is the impact of becoming the world's largest debtor Nation? This is serious; Senator Chiles already referred to this. In 7-short years, we have gone from becoming the world's leading creditor Nation to the world's leading debtor Nation. Our debt exceeds that of Brazil and Mexico combined. What will this mean to the country's security and independence in the future if we find that many of our decisions are made by bankers thousands of miles away and foreign governments thousands of miles away? We are beginning to see the impact of this, and I think it is a very serious consideration for us to look at.

The impact of debtor status can be seen best by looking at how other countries who are debtor nations find their economic and political independence compromised. Decisions about their basic reindustrialization and growth are made by other interests outside of their own borders.

Another question is, what laws discriminate against U.S. companies in favor of foreign companies? We found banking laws, antitrust laws, mineral leasing rights laws discriminate against U.S. companies in favor of foreign companies. I will go into that later if you are interested in pursuing this question.

The real question, though, is how foreign money has affected political independence. We keep seeing signs all over to the effect that foreign investment has compromised U.S. political independence. I think the most striking example of this is the defeat in California of the unitary tax. We went out to California, studied the issue, and wondered how one of the richest States in the Nation willingly gave up between $300 and $600 million a year in taxes after repealing this unitary tax. It took the foreign multinationals and the governments that supported them at least 5 years to do this, but they banded together and won. And most important of all, they formulated the issue. They decided the confines of the issue of the unitary tax in such a way that almost forced the California legislature to capitulate.

One of the most interesting strategies that the foreign multinationals used was something called the "threat power". And we see this now being used by foreign multinationals to great effect here on the Hill with regard to the Bryant amendment. "If you pass the Bryant amendment', as with the unitary tax, "if you do not repeal the unitary tax", we will pull our investment from your State.

There is no sign in any State at any point that we have seen in our 4 years of research where a foreign multinational has pulled an investment out. This is simply an empty threat. It is the use of a threat power, and it is very effective because it scared the California legislature into repealing this tax, which will cost that State hundreds of millions of dollars every year. This threat power is very effective, and we see it increasing; and there is no evidence to show that these foreign multinationals will pull their investment. The only evidence is that legions of lobbyists say they will withdraw their investments. But it is very effective, and I think we should look at it and see it for what it is: a threat.

The most important issue focuses on the erosion of American political and economic independence that has just begun to emerge. Firms must protect their investments, and America is no more immune from their influence than Brazil. We are operating under the myth that money is neutral. Investors just come in to make a profit. And while they do come in to make a profit, they have to protect their investments. Ask any former colony if money is neutral. Ask Indians if the East Indian Tea Co. just came in there to make a profit, and I think you will get a very interesting answer.

Backed by their governments, foreign companies have plunged into American politics; they have entered U.S. elections; they have formed their own PACs. There are a hundred PACs now run by foreign multinationals. They have changed State tax laws; they have successfully lobbied Congress for a range of grants and tax abatements.

We applaud America's entry into the global economy. I think it is exciting. It had helped America. But in the process, we have to make sure that America retains its political and economic independence at the same time it enters and plays the game of global economics.

Thank you very much.

Chairman CHILES. Thank you.

[The prepared statement of Dr. Tolchin follows:]

TESTIMONY
OF

Dr. Susan J. Tolchin
Professor of Public Administration
School of Government and Business Administration
The George Washington University

Before the
Committee on the Budget
U.S. Senate
Washington, D.C.

March 22, 1988

I welcome this opportunity to testify on the subject of foreign investment in the United States. My comments are drawn from Buying Into America - How Foreign Money is Changing the Face of Our Nation, co-authored by Martin Tolchin, and published last month by Times Books/Random House.

Foreign investment is changing the face of America, the lives of Americans, and the nature of our political processes. A surge of foreign money is rebuilding the nation's cities, reshaping basic industries, and building manufacturing and assembly plants that are creating jobs for millions of Americans. Mayors, governors and public officials are circling the globe in quest of foreign funds, with the intensity of third-world ministers trying to stave off the financial collapse of their shaky governments.

This trend is accelerating at a rapid pace, spurred by the drop in the dollar. Evidence of the surge in foreign investment appears in daily headlines announcing Campeau's attempt to purchase Federated Stores, the Bridgestone acquisition of Firestone's tire division, and the Saudi offer to buy Texaco, to name a few. A leading investment banking firm in New York has established a "Bargain Basement" committee for the sole purpose of identifying vulnerable American assets for its foreign clients.

At this point, foreign investment has reached a record $1.5 trillion, a significant increase from $196 billion in 1974. About three-quarters of this investment is in government and private securities, so-called portfolio investments, with foreign investors now holding more than $200 billion -- or one-tenth -- of America's $2 trillion national debt. It is important to note that 20 percent of all foreign investment is held by foreign governments, as opposed to private investors. Foreign companies are buying up American oil and gas companies at a rapid rate and are making significant inroads into a host of other industries, including the construction industry, machine tools, automobiles, auto parts, and tire production. More than half the nation's cement industry and four of the nation's top ten chemical companies are foreign owned. Foreign investors have bought land, skyscrapers and shopping centers in virtually every state of the union, and hold large chunks of prime downtown real estate in cities across the nation. More than 16 percent of total U.S. banking assets are owned by foreign investors, and the figure is climbing. Foreign investors also have become the new lions of Wall Street, indicated by recent purchases of investment banking firms.

The surge of foreign investment has occurred without a national debate, and with only scant attention paid by Congress and the executive branch. This is clearly a national issue, which begins with America's increasing dependence on foreign investment and what this means to the future of our country.

Foreign money has affected the American economy with an impact that is only beginning to be appreciated. Part of a shift toward a global economy, foreign investment continues to be coveted -- and, indeed, subsidized -- by American texpayers, at the behest of leaders who are motivated by the very real need to create jobs and finance the deficit. But we must recognize that the price may be high. Some of these foreign investors have hidden agendas, including the destruction of American competitors and the acquisition of American technology; many are motivated by a desire to avoid protective tariffs and view foreign investment as part of their nation's export strategy, to increase their market share.

Most important of all: foreign investors have emerged as key players in American politics, making their influence felt on every level of the process. If this continues, the threat of losing a measure of political and economic sovereignty becomes a real possibility.

In an ideal world in which free trade and barrier-free investment were the rule rather than the exception, the U.S. laissez-faire position would make sense. In the real world, it raises questions about the collective long-term effect of the nation's deepening dependence on foreign money.

Some of the questions that can be addressed by Congress include the following:

1. What are the effects of increased competition among the states and the cities for foreign investment?

The states are engaged in economic fratricide. They vie with each other to see who can offer the most tax abatements, grants, real estate and loans, while the foreign multinationals sit back and wait for the best bargain. While our trading partners carefully coordinate their policies toward foreign investment, the United States has embarked on a free-for-all that can only make it less competitive in the long run if it continues to dissipate its resources in this way.

Such state and local incentives play a minor role in the decision to invest. Foreign companies come to the United States primarily to make money, corner the lucrative U.S. market, avoid protective tariffs and acquire new technology. No one doubts that Toyota had every intention of locating a plant in the United States with or without $125 million in incentives from Kentucky. Taxpayers are just beginning to question this unnecessary expenditure of their hard- earned money and, in some cases, turning the political leaders who were responsible for these giveaways out of office.

The rush to inundate foreign investors with incentives rests on the assumption that all foreign investment is beneficial. In effect, the U.S. is subsidizing the surge of foreign investment without assessing its impact on the nation.

2. What is the impact of America's entry into the ranks of the debtor nations?

In 1985, the United States joined Argentina, Sudan and a host of third-world countries and became a net debtor nation; that is, the United States owed more money to foreigners than foreigners owed the United States. It was the first time since World War I that America had crossed the line into international indebtedness, and the first time in history that an advanced industrial nation had reverted to debtor status in peacetime.

It happened swiftly, and caught policymakers off guard. The United States shifted from being the world's largest creditor nation in 1982 to the largest debtor in 1986; its debt surpassing Brazil and Mexico combined. By the end of 1987, the net foreign debt exceeded $400 billion. Experts predict that by 1990, America's net debt to foreigners will reach the $1 trillion mark; Japan, the world's leading creditor nation, will hold $400 billion worth of U.S. debt.

It is true that the United States remained a debtor nation throughout the nineteenth century, with European investors putting their money in railroads, canals, factories and mines -- projects that enabled the United States to create its own economic miracle. The situation is different today: Much of the foreign borrowing is not for reindustrialization but to pay for the country's habits of overconsumption, and to finance the burgeoning budget deficit.

The costs of debtor status run high. Debtor nations live on the brink of crisis. They are owned by foreign investors -- by individuals, by nations, and by other forces beyond their control. Their dependence on foreign capital means they are constantly subject to the will of foreign bankers, who set their priorities and decide what they can buy and how much they can spend. The pace of their industrialization is set thousands of miles away by people with little stake in the quality of their lives or the long-term future of their nation. "Debtors" gradually experience a loss of sovereignty, a diminution of power in the most basic areas of economic and political development.

3. What evidence is there of a loss of political sovereignty?

In California, foreign investors penetrated down to the level of influencing state tax laws when they banded together and forced the state legislature to repeal the controversial unitary tax. The hidden lesson of unitary tax reform poses a disquieting question: What happens when foreign firms wield more clout than our own? The answer led many to proclaim a new and unfettered era of foreign investor influence in America.

How did this come about? Why did the nation's richest and most powerful state risk relinquishing between $300 million and $600 million a year in tax revenue? Years from now, when political leaders seek funds for highways and textbooks, they may look back and wonder how and why their state gave away so much for so little.

The issue was formulated by foreign multinationals and their governments. They fought a well-financed, heavily lobbied campaign that signaled their growing influence to frame political issues and wield clout. They spent hundreds of thousands of dollars on state legislative campaigns. Soon the unitary tax was known as the "juice bill" for the dollars that could be squeezed from it. When money alone failed, foreign firms toughened their stance and threatened economic blackmail -- threats not to invest in California in the future, and to pull existing plants out of the state. At the last stages, foreign governments emerged as key players. Prime Minister Margaret Thatcher pressed President Reagan to intervene on behalf of foreign governments.

In capitulating to foreign multinationals, California lost some of its political independence, leading some to compare the state to a colonized nation.

4. What is the impact of inadequate data collection?

The U.S. is flying blind on foreign investment. No one knows the full extent of foreign investment, and some experts believe at least 50% of all foreign investment is unreported. Lax reporting requirements, hidden ownerships, and other circumventions of the laws -- many of them already riddled with loopholes -- have made it virtually impossible to keep track of the flood of foreign money. Urban real estate is probably the hardest to track, followed by manufacturing, agricultural land and securities.

Areas most in need of improved, systematic information include:

* The technology drain. Where are foreign investors investing to acquire American technology? What effect does this have on the national defense and on American industry? In the case of joint ventures, where does the R & D end up? In the United States or abroad? What will Japan's investment in Boeing, for example, do in the long run to America's lead in the aerospace

industry -- the last high-tech industry in which the United States is still predominant?

* The money drain. Where are the profits going? Is foreign investment as good for the American economy as it's cracked up to be, or do most of the profits return abroad? in 1985, 79% of the profits of foreign-owned U.S. firms were repatriated back to the foreign parent.

* The industry drain. What industries can the nation afford to lose? Can the United States afford to lose the aerospace or semi-conductor industry to foreign interests? Can it afford to sell off its natural resources as rapidly as foreign investors can buy them up?

* The government connection. What is the difference between individual foreign investors and foreign governments? Should government records differentiate them? In 1987, for example, foreign governments replaced private investors as the major purchasers of U.S. government securities. In a dramatic turn of events last May, these governments declined to bid on a $29 billion offering of T-bills until the terms were improved. Treasury officials capitulated, solidifying the position of foreign investors, who would henceforth play an even greater role in determining U.S. interest rates and setting the course of the U.S. economy.

* The preemptive strike. What U.S. industries are being driven out of business by unfair competition from foreign investors? Is there a level playing field, or are some companies being subsidized by their governments?

* The fairness issue. Most countries restrict foreign investment, failing to reciprocate the warm welcome their nationals receive in the United States. Investment barriers remain a real problem to American investors, mirroring the trade barriers faced by manufacturers seeking to export their products.

Attempts to improve data collection, such as the Bryant amendment now before the trade conference, have been met with intense lobbying, led by representatives of foreign multinationals and the governments that back them. Members of Congress and their staffs were warned that any effort to improve disclosure would lead to drastic reductions in foreign investment. The proof? Only the fact that legions of lobbyists said it was so. No one has seen any data to back up this threat, but few have questioned its legitimacy.

Faced with threats of retaliation from their foreign counterparts, some major U.S. multinationals have joined the effort to beat back improved disclosure. One wonders what form

that retaliation would take, since other industrialized nations scrutinize foreign investment very carefully.
In fact, many of them limit investment in land, high tech industries, manufacturing, banks and the media.) What do they know that we don't? They know that countries can't make decisions on the basis of incomplete information.

3. What is the impact of foreign investment on national security?

It is a mistake to allow any country to get control of businesses vital to the national defense. This issue arose at the time of the impending acquisition of Fairchild Semiconductor -- already controlled by Schlumberger, Ltd., a French firm -- by Fujitsu, Japan's largest computer company. Fairchild makes the components for the supercomputers that make or break codes and target nuclear weapons; they are a vital part of Star Wars research. The acquisition of foreign firms of such vital industries led the late CIA Director William Casey to warn that foreign investment was a Trojan horse, friendly on the outside yet inimical in many ways to the nation's interests.

The national security question is broader than supercomputers. We must ask questions about a host of other industries and their relationship to the national defense. Are there any other industries where we should reserve an American component? Tire production? Real estate? Machine tools? Oil? Banks? Telecommunications? Should there be a limit on foreign ownership, and if so, how much?

Americans are so hungry for foreign money that they are often blinded to problems of national security, and fail to take appropriate steps to monitor the source of foreign funds and protect themselves against hostile incursions until it is almost too late. Several years ago, for example, the Soviet Union was able to purchase four banks in Silicon Valley through Moscow Narodny, its overseas bank. The sale was aborted by an alert CIA official who recognized the Singapore businessman acting as a front for the Soviets. Had they been able to complete the sale, Soviet agents would have had access to U.S. technology, as well as the financial structure of Silicon Valley -- where they would have been able to identify the individuals most susceptible to financial pressure.

4. What laws unfairly discriminate against U.S. companies in favor of foreign companies?

What laws, for example, are not being enforced for fear of losing foreign investment? Are federal and state officials afraid to enforce labor laws, affirmative action laws and antitrust laws for fear of discouraging foreign investors?What loopholes in American election laws should be plugged to prevent undue influence from foreign governments and foreign multinationals?

For a period of time, U.S. banking laws discriminated against American banks in favor of foreign banks. U.S. banks were prohibited from interstate banking, while foreign banks could operate across state lines. Foreign banks took full advantage of this inequity and cornered a large share of the American market. Their head start continues, as capital rich nations buy into our nation's banking assets. In the largest purchase to date by the Japanese in an American financial institution, the Bank of Tokyo recently purchased the Union Bank in Los Angeles for $750 million. The Union Bank is California's fifth largest bank with assets of $9 billion. This means that Japan will now control five of California's ten largest banks.

- -

These questions represent a small sample of the issues raised by the surge of foreign investment in the United States. The larger issue focuses on the erosion of American political and economic independence that has compromised officials on all levels of government. Money is rarely neutral, as any former colony can tell you. Firms must protect their investments, and America is no more immune from their influence than Brazil. Backed by their governments, foreign companies have plunged into American politics: They have entered U.S. elections, formed their own Political Action Committees, changed state tax laws, and successfully lobbied Congress for a range of grants and tax abatements.

New evidence has recently come to light indicating serious public concern about foreign investment. Smick-Medley Associates, a Washington consulting firm, released a survey showing that the public was "restless and concerned" about growing foreign investment in the U.S., with 78% of those polled favoring a law to limit the extent of foreign investment in business and real estate.

Those who have ventured forth to look at the policy implications of foreign investment are often labelled "protectionist," "xenophobic," and "racist." It is easier to attack with cliches than to deal with substantive issues; it is a quick and effective way of dismissing problems that call for more thoughtful consideration.

It is time for responsible leaders to take a long, hard look at their country's growing dependence on foreign capital. It is too reminiscent of America's dependence on foreign oil, and just as we shook ourselves loose from OPEC cabal, we must reduce our craving for foreign money. The U.S. is sinking deeper and deeper into the condition of a developing country: importing capital when as recently as 1982 it was the world's largest creditor nation. Advanced countries export capital, and that's the company this nation should keep.

I applaud America's entry into the global economy, but the forces of the international marketplace have overwhelmed America's capacity to deal with them. The surge of foreign investment is one important example. The manner in which the nation's leaders respond will determine how we meet the most difficult economic challenge of our time: to retain U.S. sovereignty in the global economy.

Chairman CHILES. Mr. Powell.

STATEMENT OF JAMES POWELL, NEW CANAAN, CT., AUTHOR OF "GNOMES OF TOKYO"

Mr. POWELL. Thank you.

America became the most prosperous and powerful Nation on earth by giving people the vital freedom to choose.

We have attracted countless foreign entrepreneurs who created jobs and prosperity in America. Just think of the great enterprises of John Jacob Astor and Alexander Graham Bell and Adolphus Busch, Andrew Carnegie, William Colgate, Samuel Goldwyn and Helena Rubinstein. I was fortunate to interview Italian-born Anthony Rossi, who built Tropicana, a billion-dollar company employing 3,400 people in Florida.

For as long as anyone can remember, Americans have benefited from foreign investment. During the 19th century, low cost British capital helped finance construction of our railroads, and before long, we were actually exporting locomotives to Europe.

The Bank of Tokyo opened its first U.S. office way back in 1885. Now, the Bank of Tokyo employs about 5,000 Americans.

In 1900, Swiss-owned Nestle began its U.S. operations with a condensed milk plant near Syracuse, NY. Nestle employs about 5,000 Americans.

Dutch-owned Shell Oil began refining petroleum products in Wood River, IL, in 1918. Shell employs 33,000 Americans now.

Honda, in Marysville, OH, not only employs 5,700 Americans, but they are actually exporting cars and motorcycles from America to Canada, Mexico, Australia, Taiwan—and, yes, Honda America is also exporting cars to Japan.

While creating 3 million jobs, foreign investors give us more benefits. They help energize American communities. Often, foreign investors have introduced substantially better management practices: more attention to employee needs, more flexible organization, higher productivity, and, therefore, more greater job security.

And, of course, the renewed emphasis on quality owes much to intensified foreign competition for American customers.

The bottom line is that foreign investors benefit Americans just as IBM, Coca-Cola, Hilton, Levi Strauss, Walt Disney and other American companies have benefited people around the world for decades.

Moreover, America gains from lower cost capital, wherever it comes from. We did not become the most prosperous Nation on earth by paying $511 for 60 cent light bulbs, like the Defense Department has done on occasion.

Freedom to choose lower cost capital is crucial because a company commonly needs between $75,000 and $150,000 of assets to create a new job. The most capital-intensive industries, like petroleum distillation, need as much as $770,000 per job. The more capital that is available for investment in America, the more American jobs there will be.

In this decade, Japan and Western Europe have exported huge volumes of capital, while the United States has imported capital.

As you know, we have created 2.5 times more jobs than Japan and Western Europe combined.

When the volume of capital increases faster than the work force, wages and salaries go up faster as employers compete for workers to operate new word processors and factory machines and other productive tools.

What about the fear that we are mostly generating job flipping hamburgers and taking out laundry? It is a myth. The Bureau of Labor Statistics reports that more and more people are taking entry level jobs in higher paying occupations which offer greater opportunity for upward mobility. Jobs are being created fastest in the top third of the wage scale today.

So more capital means more American jobs and better paying jobs, regardless where the capital comes from.

Hundreds of American companies become more competitive by using lower cost funds from foreign lenders and investors. For instance, American Airlines, Chrysler, Dow Chemical, Ford, General Electric, General Motors, IBM, Macy's, Sears, United Technologies and so on.

All of these are sophisticated companies which have many choices. U.S. lenders solicit their business every day. Yet often the lowest cost deal is from a foreign lender. So it is absolutely not true that we are becoming dependent on foreign capital. We could use more expensive sources of capital, but why pay more than you have to for anything? It is un-American.

Because lower cost capital is available, American companies realize huge savings. For example, when a company wants to finance a factory, an office building or other real estate project, Japanese banks offer more flexible terms and lower rates, so their loans can be 30 to 50 percent less expensive in many cases.

In a single transaction with Mitsubishi Trust & Banking, IBM will save an estimated $9 million on the cost of a new Southbury, CT, office facility. It will employ 3,000 Americans.

During the past 5 years, Japanese securities firms have managed $13 billion of Euromarket financings for American companies, further lowering their cost of capital. Revlon, Merrill Lynch, Texas Instruments, Digital Equipment and others have saved hundreds of millions in the Euromarket.

Foreign lenders do not just serve major American companies. Thousands of middle market and smaller American businesses benefit, too.

For example, Chicago-based Sanwa Business Credit Corp. has loaned $1.2 billion to about 1,100 American manufacturers which produce circuit boards, auto parts, machine tools, textiles, tires, toys, chemicals, plus companies that sell computers and peripheral equipment and other items to more than 18,000 American customers.

Access to equity capital is more important than ever. During the past decade, interest payments have become a bigger expense for American corporations, and now interest is equal to about half of American profits.

During 1987, Japanese investors bought an estimated $17 billion of U.S. equities, up from $7 billion in 1986. Without foreign participation in U.S. equity markets, the cost of capital would increase.

To take advantage of low-cost foreign capital, more and more American companies solicit funds abroad. Among them: American Express, Anheuser-Busch, Bell Atlantic, Chrysler, Citicorp, Exxon, First Chicago, General Motors, The Limited, McDonald's, Merrill Lynch, Procter & Gamble and Walt Disney.

All these American companies—which are free to choose among many financing alternatives—believe it is in their interest to tap lower cost equity capital in Japan. They are among the American companies listed on the Tokyo Stock Exchange.

Despite all these American jobs and benefits, some people pursue a xenophobic campaign against foreign lending and investment. But nobody demonstrates any dangers. Where is the beef?

To begin with, foreign direct investment accounts for only about 5 percent of total U.S. assets. That is it; 5 percent.

Chairman CHILES. How quickly has that risen in the last couple of years, though? What was it 2 years ago?

Mr. POWELL. Maybe 1 or 2 percent.

Chairman CHILES. You are right. You are right.

Mr. POWELL. These things go in cycles, and we can expect that that will change when the exchange rate and other situations change. But it sounds to me like McCarthyite or John Birch Society conspiracy theories to insinuate that America is being taken over by hordes armed with Honda cars, Lifebuoy soap, Bic pens and Nestle chocolate bars.

The fear campaign against foreign investment is based on the myth that American entrepreneurs are giving away valuable assets. Did William Paley and Lawrence Tisch give away CBS Records for nothing? Of course not. They got $2 billion out of Sony.

Chairman CHILES. And they do not give a rap what happens to anything else, as long as they get their money either.

Mr. POWELL. We are the ones who got the money. They have to put their money out for a profitable return. The only way to do that is to produce products in a competitive market.

If Mr. Paley and Mr. Tisch actually lost control of that $2 billion, I would think the SEC should be informed.

Every time a foreign investor buys something, Americans get money. We Americans do better at investing our money than just about anyone else in the world, because our markets are open, and money management is an entrepreneurial business that Americans seem to excel at. Foreign investors express their confidence in American management by buying American stocks.

Through most of last year, 83 percent of net buying in U.S. stocks took place during the first 30 minutes of trading when Japanese and European orders came into the New York exchanges.

It does not make any difference in a competitive marketplace whether a business owner is Jewish, black, Hispanic, Chinese, Japanese or anything else.

American consumers, employees and suppliers are protected by the availability of alternatives in competitive markets. Consumers are always free to buy elsewhere. Employees are free to switch jobs if they do not feel they are paid enough or they are not treated well or you do not have enough opportunities for advancement or whatever. Suppliers are free to stop shipping if they are not getting paid promptly enough.

American commercial and residential tenants are free to choose among alternatives, too. They will move if a landlord charges too much rent or does not provide adequate building services. And, as you know, commercial vacancies are high across the country. We are very much in a buyer's market, so tenants are well protected.

And, of course, foreign investors are generally subject to the same laws as U.S. companies. Consumers, employees, suppliers and tenants can seek remedies from courts or regulatory agencies against anyone doing business in the United States.

In any case, there is not a shred of evidence that United States and foreign investors have fundamentally different aspirations. We all seek safe places to invest our savings for the best returns.

Like American investors, foreign investors favor low taxes, low inflation, low crime, predictable laws and good education—the kinds of things which foster prosperity and jobs all around.

I might be more concerned about foreign investment if I found out that they were lobbying for higher taxes, higher inflation, crime on the streets and bad education. But we do not see that, do we?

Proposed restrictions on capital markets would be laughable if they were not so dangerous. Restrictions will threaten American strength and security five ways.

First, any such restrictions will handicap American companies and give important competitive advantages to other countries, jeopardizing American jobs.

American high technology companies will be especially hurt, because they need so much capital for research and development. They need all the capital they can get to build tomorrow's technology.

Second, restricting foreigners from bidding on U.S. companies will lower the value of U.S. companies, making it more difficult for them to finance expansion and create jobs.

When the government pressured Fujitsu to withdraw its offer for ailing Fairchild, it was picked up by National Semiconductor for $122 million, or half of what Fujitsu had offered. As a result, Fairchild has a much harder time raising funds which it needs to turn around. Whatever the national security concerns, it is hard to see how they would have been any different, since Fairchild was owned by Schlumberger, the oil services company based in socialist France.

If CBS were restricted from dealing with a foreign bidder when it sold CBS Records, the company would have been denied $2 billion for future projects, because there was not any American bidder for that property.

Similarly, if Firestone were restricted from dealing with foreign investors, its stockholders would have been denied $2.6 billion to redeploy as they wish, because the only major bidders were from overseas.

And do not forget that those stockholders include pension funds which millions of Americans participate in.

In these cases and many others, reducing the value of American companies by excluding potential bidders will do more damage than the October 1987 stock market crash. The October stock crash reflected about a 20-percent decline in U.S. equity values. We have already seen in the Fujitsu case a 50-percent hit on investors, many of which are American because Schlumberger is listed on the Big Board.

Third, restrictions on foreign capital will undermine the primacy of U.S. capital markets. Business and jobs will be transferred from New York to London and Tokyo.

Recall how the United States imposed taxes and restrictions against foreign investors during the 1960's. Funds flowed to Europe, and the fledgling Euromarket took off like a shot. It is a $650 billion market now.

Frankfurt lost its chance to become Europe's financial capital because they retained so many restrictions in their capital markets. Money flowed to Britain, a smaller country which had the good sense to keep hands off the London financial markets. And so London is the undisputed king of European finance.

Tokyo has emerged as a global financial center only since Japan started deregulating its financial markets in 1980. Now, there are more non-Japanese companies listed on the Tokyo Exchange than non-United States companies on the New York Exchange.

Fourth, restrictions against foreign capital can easily encourage foreign governments to retaliate with new restrictions against the estimated $900 billion of U.S. international investments.

Who knows what mischief foreign government may devise? Reprisals could develop into devastating economic wars such as those which helped trigger the Great Depression, when more than 60 foreign governments retaliated against the Smoot-Hawley tariff within 2 years after President Hoover signed it—and our imports, exports and gross national product plunged more than 50 percent.

Fifth, restrictions against foreign capital will threaten our international alliances.

Japan-bashing may be popular now, but Margaret Thatcher's Britain is the biggest foreign investor in America, with $70.5 billion of U.S. properties. Next come the Dutch with $51.5 billion and then the Japanese with $30.9 billion, then the Canadians with $19.7 billion.

Other major foreign investors include West Germany, France, Switzerland, Sweden. All of these are friendly countries and allies.

In a dangerous world, it surely makes sense for us to strengthen our alliances, not spite our friends.

Just because some smaller, less successful countries restrict, even ban foreign lending and investment is not a good reason for us to follow their bad example. There are lots of things other countries do which would not be right for America.

Blessed with a competitive business climate, Americans have gained more than $1 trillion from foreign investors in this decade. An estimated 65 percent of that $1 trillion is in the private sector where it can be invested productively for the future.

By keeping our capital markets open, we will make America richer and stronger, and we will control our destiny.

Thank you. I welcome any questions you may have.

Chairman CHILES. Thank you, Mr. Powell. We have got a good cross-section of opinion here, to say the least.

Doctor, last week the Commerce Department reported the current account deficit for 1987, which is the best measure of what is happening to our international indebtedness. We hit another world record with our net debt to foreigners increasing by $160 billion in 1987. That same report said that the 1987 direct foreign investment in America increased by some $40 billion. At the same time, we are reading in papers like the Wall Street Journal that the Commerce Department's numbers could be underestimating the true amount of foreign investment by as much as 50 percent.

Do we have any sure way of knowing the amount of foreign investment in our country? Do we really know who the investors are and where the money came from and what is being put into it?

Dr. TOLCHIN. At this point we do not. The SEC, for example, does not list these companies by the name of the parent company or by country. So it would take about 10 years to find out, and by that time it probably would be too late.

The current data collection is shared by about 16 different Federal agencies and is inadequate, at best, to figure out the true picture. But you are very correct in saying that these are serious numbers. They may at this point represent a total amount of foreign investment, even if it is underrepresented by 50 percent, may represent only about 8 percent of our total assets. But we really do not know that for sure, and with the rapidly expanding inroads that foreign investors are making, these figures, as they increase geometrically, are going to have an even grater impact.

Chairman CHILES. What about our other foreign competitors? Do they monitor foreign investment more carefully than we do?

Dr. TOLCHIN. Yes; much more closely. The major industrialized countries do monitor foreign investment much more closely than we do, which raises the question: If they are going to retaliate against us if we improve disclosure, exactly where are they going to retaliate? Many of them cannot strengthen their disclosure amendments much more, and along with some of those disclosure requirements in other countries are restrictive requirements.

In other words, along with disclosure, other countries also restrict foreign investment. We are not talking about Peru. We are talking about Japan and Korea and Switzerland and so on. The Bryant amendment is much weaker actually, than the kinds of requirements for data collection in other countries.

It is curious to me, when the lobbyists say that they will retaliate, I wonder on what grounds they are going to retaliate. They are going to have to retaliate in other areas. They cannot retaliate, really, with tightening up their own disclosure because their own disclosure is——

Chairman CHILES. Because they are already requiring it.

Dr. TOLCHIN. Right. They already require it. That is correct.

Chairman CHILES. Mr. Powell, I have always been a proponent of open markets all around. America might have some trade barriers, but a $160 billion trade deficit tells me that foreign goods do not have much trouble coming into this country.

One aspect of the foreign investment that worries me is when a foreign company is protected in its home markets, in which our firms do not have a fair chance to compete, such as semiconductors, electronic equipment, it turns around and then uses its profit to buy out an American semiconductor or electronics equipment firm.

It seems to me that there is just something basically totally unfair about that, and that we ought to think twice about letting foreign firms who use trade barriers to become strong come along and then use their ill-gotten gains to acquire our companies.

Would your open-door policy on investment allow foreign firms that had been subsidized by trade barriers or some other method come in and buy out our particular firms?

Mr. POWELL. If someone is actually willing to subsidize American consumers, I would say thank you very much. There are all kinds of comparative advantages in the world. There is dumb luck. There are labor advantages, location advantages; natural resources, technology, political stability, the tax and regulatory climate and so on. Consumers seldom know exactly why they're being offered a bargain, but we're better off because we're free to shop.

Chairman CHILES. How would you like to be a person that created a semiconductor business or was a stockholder and helped start it? Tool manufacturing, for example, machine tools? We had a Florida firm that was literally put to the wall and out of business because the administration would not do anything about the dumping and the foreign competition and then find that then you are acquired by a foreign company.

Is there not something basically unfair about that? I mean, you are looking at this overall global picture. But isn't an American entrepreneur entitled to some kind of protection if he has tried to create a business?

Mr. POWELL. Which entrepreneurs? When the government a year-and-a-half ago set about trying to create a semiconductor cartel, we penalized other American entrepreneurs in the computer industry which buys semiconductors. This was recently a flap where Atari, for example, is suing an American semiconductor company for reneging on contracts and doubling prices.

We simply transfer unemployment from an industry which is under pressure, such as semiconductors, to another American industry buying that input. We have seen the same thing happen dramatically in the steel industry when we imposed quotas on steel. President Nixon started the current trend toward protectionism by putting in quotas on steel in 1969, and they increased the cost of steel to American companies which buy steel for all kinds of things like automobiles, screwdrivers, machinery and appliances.

Well, there are about 22 times more people working in the steel-using sectors of the economy. Consequently, pushing up the price of steel for American companies which use steel makes their products more expensive. There was less demand and more unemployment in the steel-using sectors.

The net effect of trying to benefit steel-producing companies was to transfer unemployment to steel-using industries and destroy more than 50,000 American jobs net. Beyond that, the biggest hit is always on the consumer.

Chairman CHILES. Do you see any problem in the effect that the transfer of technology? When there are no restrictions, you can come in and buy a company. You can get all the technology that we have spent our money developing, our R&D and all of our research, and hopefully what allows us some kind of a trade advantage, and boom, that is gone the minute you can come in and purchase that technology.

Mr. POWELL. Well, this is a global economy. One of the biggest computer producers in Japan is IBM. Texas Instruments is very big in Japan. There are 50,000 American products sold in Japan. Many of these are high technology.

The overall point of trade policy is to create more prosperity and more jobs, and the best way we do that is to let the markets tell us how best to deploy our resources. Everybody is more prosperous in open markets.

Chairman CHILES. But if we are not allowed to compete on the same basis in their market, how in the world can we turn around and let them come in and buy us out in our market?

Mr. POWELL. Well, I certainly appreciate the anger of American exporters who are frustrated by Japanese bureaucrats. However, keep in mind the overall picture; exports——

Chairman CHILES. That is interesting. From that standpoint, you say you appreciate it. But if we talk about anything on this side, you talk about a global trade war that will destroy America. Why the hell ain't there a trade war when they put all their barriers up? What happens to the trade war then? What happens to the trade war? They will not allow us to compete on the same basis in their financial markets.

Yes, they have opened up some, but not where we could have a basic advantage. We cannot buy their 10-year bonds. We cannot sell in their 10-year bond market. We cannot get in much of their security market. As soon as it looks like we no longer have an advantage, then boom, they will let us in.

But that does not create a war. That does not destroy their markets. They are growing like crazy. But on the other side, you say if we do anything, including something like the Bryan amendment or getting information, oh, look out, we would create a war and we will suffer.

Mr. POWELL. The country which imposes restrictions against talent, goods and capital is the primary loser from those restrictions.

Chairman CHILES. Has Japan been a loser?

Mr. POWELL. Absolutely. Their consumers are poorer. Their farmers are less competitive than they otherwise would be.

Chairman CHILES. Have they been a loser when they put trade barriers up and then created a semiconductor industry, an electronics industry, beefed those up with their low subsidized loans, allowed them to go into other countries and operate with loss leaders and under the market and built a tremendous industry as they protected them all the time? Did they lose by that?

Mr. POWELL. Yes.

Chairman CHILES. That was the damn smartest policy in the world. You cannot tell me they lost by that.

Mr. POWELL. It cost them the shipping business; it cost them the textile business.

Chairman CHILES. Cost them the textile business?

Mr. POWELL. Absolutely. They have lost business to Taiwan and Korea and Singapore.

Chairman CHILES. They lost that on the labor differences. They did not lose that because they protected their electronics industry, did they?

What I am saying is, they had a strategy that they protected some fledgling industries. They said we are going to go out and capture that market and they did. They did not lose by it; they gained tremendously.

Mr. POWELL. The Japanese Government never spent as the United States subsidizing semiconductors. Back in the 1960's, more than half of U.S. semiconductors went to the Defense Department. Even now, the U.S. Government funds almost 50 percent of U.S. R&D.

As far as proctecting fledgling industries, Japanese on semiconductors never got above 12 percent in the 1970's. Since 1983, the Japanese have not imposed any duties on semiconductors. The Japanese pay very heavy prices for their protectionist policies. They pay about eight times the world price for meat; they pay five or six times the world price for rice.

Chairman CHILES. That is strictly government policy because they do not want their people eating meat. They want to make them to save money. They want to force them to save.

Mr. POWELL. Farmers are as powerful there as our farmers are here.

Chairman CHILES. You have not answered my question whether it hurt Japan in building these tremendous electronic semiconductor industries that they built when they used trade barriers and they have used everything else to protect them. That did not hurt them. They gained by that tremendously.

And yet you say if we do anything down here, anything in this country to protect anything, we are going to start a world war, a trade war.

Mr. POWELL. The Japanese do not owe their success in semiconductors, to trade barriers, or government subsidies, since both countries have provides subsidies. The Japanese concentrated their R&D on basic research and commercial applications. The United States has concentrated R&D on defense applications. Our Defense Department's $1 billion very high speed integrated circuit program, for instance, has yielded almost nothing of commercial value. In any event, the primary case against protectionism is that it hurts the country most which imposes the barrier.

Chairman CHILES. That is the primary argument, but you cannot show me how it has happened in Japan. You just have not been able to convince me that they lost by that argument. I think they gained tremendously. I think they built an industrial might, especially in high tech, that is the envy of the world now.

Mr. POWELL. Well, the Japanese restrictions, one of the effects of restrictions is it subsidized foreign R&D. We have done that in the automobile industry by restricting imports and encouraging foreign companies to go from the lower end from cheap cars to more expensive cars. The effect is that the U.S. restrictions have subsidized foreign, in this case Japanese, R&D.

Chairman CHILES. Well, you see, we did it on a different basis. We were not as smart. We did not require them, and they did not then take that additional profit they had and plow that back into

R&D. They went and bought other companies. They went up on their prices and distributed money, great big bonuses to their top management. They paid it out to their stockholders. They did not do it the way the Japanese did it, being smart in taking that time and that tremendous profit and putting it back into R&D. We were dumb about it. And we who allowed them to restrict those imports were dumb because we did not require them to do that.

So, yes, it worked the wrong way. But had we restricted the imports and plowed it all back into R&D, it would have been a different situation.

Mr. POWELL. We certainly have very little experience to support that as a result of U.S. policy. We see the effect of protecting the steel and automobile industries They do not reinvest to lower their costs.

Chairman CHILES. You are right. I agree with you.

Mr. POWELL. Unless they are against the wall, they are under pressure and they absolutely must do something to improve the quality, to improve their R&D or whatever it is to be more competitive.

Chairman CHILES. I agree with you.

Senator SYMMS.

Senator SYMMS. Thank you very much, Mr. Chairman. I want to thank both of you for being here. I found your testimony both very challenging and very interesting.

I want to ask one question in reference to what the chairman just pointed out. It will just take a yes or no answer. Basically what we are talking about is: Do you believe that economic competition in the abstract is fair or unfair?

Dr. Tolchin, do you think competition in general is fair or unfair?

Dr. TOLCHIN. It is hard for me as a professor to give a yes or no answer. May I be indulged for a minute?

Senator SYMMS. Well, I want to make a point here. What I am trying to say is, if we generally agree that competition is fair, then we all need a little competition to keep us honest. Whether we are running for the Senate or whatever, there is nothing wrong with some loyal opposition to keep everybody thinking about why it is they are in the Senate or why it is they should buy a Ford versus a Honda or whatever.

My point is: Isn't it true that the Japanese have a much lower standard of living than Americans on the average?

Dr. TOLCHIN. In terms of their housing, perhaps. I understand their housing——

Senator SYMMS. Well, I mean they pay eight times as much for meat and more for sugar and more for flour and all the basic necessities, and they have a much lower standard of living. Isn't that true?

Dr. TOLCHIN. Well, that is not within my realm of expertise. But I think if I had to say one way or the other in terms of competition, is competition fair or unfair, I would probably come down on the side of unfair. It is interesting. Senator Chiles was referring to the links between investment and trade policy, and I think that is one of the myths under which we operate.

It is very clear that in the case of other countries—and this is probably where the unfairness comes in—that trade and investment policy are linked. Here we tend to separate them. We think that all investment is good, and that trade barriers are something else. But it is very clear that Japan strategizes trade and investment policy together. The Japanese auto companies, as you mentioned, invested in the United States to avoid the protectionist VRA's that we imposed in the early 1980's. The same thing happened in the television industry.

It is curious to note that the Europeans had the same experience with Japan as we did. Japan increased its investments by 100 percent between 1982 and 1985, and during that same period, the trade deficit doubled between Europe and Japan.

Senator SYMMS. Well, I want to get back on this point. I appreciate that.

Now, do you think competition is fair or unfair, Mr. Powell?

Mr. POWELL. Open, peaceful competition is absolutely fair. The issue is: Are individuals to be free, are American customers to be free to make their own choices? If you do not permit individuals to make their own choices and allow companies to compete for favor, for business, then you are talking about injecting force.

Senator SYMMS. Well, as a businessman, what the ideal world would be from my point of view if I would take off my Senate hat and put on my business hat, I would want to be a free trader for everything that I am going to buy. But I would like to sell into a controlled market where I could assure the prices stay up, so it is more profitable to do business. That is the way most people in this country are.

Some people who talk about protectionism, really, when they go shopping are not protectionists. But when they are selling something or producing something, then they are protectionists. We all have a personal vested interest. I do not say that is bad. I mean, I just think that is the reality.

But another point I want to get at is this debt we are accumulating, is this debt a consumption debt or capital-investment debt, Mr. Powell?

Mr. POWELL. About 65 percent of the debt is in the private sector. According to the Treasury Department, foreign entities hold——

Senator SYMMS. I mean, we are a debtor Nation now. So is the debt that is being accumulated here, is it invested in capital assets, that is, creating more jobs, more productivity, or is it a consumption debt?

Mr. POWELL. Well, if it is in the private sector, it is being used for productive purposes, because presumably the lenders have to satisfy themselves that they are going to be paid back.

I would note on the issue of sovereignty that the percentage of Treasury securities held by foreigners has declined 38 percent since the Carter administration. Ten years ago, foreign entities held about 26 percent of U.S. Treasury securities. Now, foreign entities hold about 14½ percent of U.S. Treasury bonds.

So if anyone is worried about foreigners holding Treasury securities, that is a problem which is declining.

Senator SYMMS. My time, as you can see, has expired. I just want to close with one question. I would just appreciate it if you would both give a very brief answer on it because there are other Senators here who want to ask questions.

How do you each answer the charge that foreign investors have a hidden agenda to destroy American industry? Try to keep your answer brief so other Senators can ask questions. I would like to hear from both of you on it.

Thank you, Mr. Chairman. I will not ask any more questions. My time is up.

Dr. TOLCHIN. The answer that I would give is that some foreign investors come in here to corner market share, and in doing so they want to destroy their American competitors. "Destroy" is a strong word, but I think that anyone in business wants to do away with his competitors. So foreign investors coming in here do have an agenda. I am not sure it is hidden. Sometimes it is; it is when the Soviet Union tries to buy banks. They do it through a middleman. So in that case, it is hidden. It is hidden when Marcos tries to buy real estate. He hides his purchases through intermediaries.

Senator SYMMS. But does he want to destroy it?

Dr. TOLCHIN. Does who want to destroy it? Marcos?

Senator SYMMS. Marcos or whoever the foreign investor is. How do we answer the charge that they want to come in here and destroy or take away our competitiveness and destroy our industrial base?

Dr. TOLCHIN. Absolutely. We see foreign investors making significant inroads in banking, machine tools, automobiles and so on. And I think as you see this steady erosion, naturally one can conclude that they are trying to destroy a certain segment of our competitive base. Semiconductors is another illustration.

When you are talking about land and real estate, it depends on whether you are a real estate agent or a developer or a consumer. In many areas of the country, foreign investors are willing to pay a whole lot more than Americans, and now with the drop in the dollar they can.

So what does that do to Americans' ability to buy their own land and commercial real estate?

Mr. POWELL. I heard someone remark that the Japanese would never bomb Hawaii again because they own so much property there. They have a very strong stake in higher property values and prosperity for America. They want their investments to be worth more.

Nobody is destroying American industry. Manufacturing contributes about 20 percent of the gross national product, and that has been a relatively stable number in recent years. Manufacturing productivity is up about 30 percent since 1982; manufacturing output is up a third.

What we see is a dynamic economy which, through competition, enables us to discover better and cheaper ways to do things. I am sure you will agree that the rise of the auto industry, which meant the demise of the buggy-whip industry, was a good thing. Americans are better off. And we see the same process happening internationally, where the Japanese became so successful in textiles and steel that they attracted new competitors, chiefly from Korea and

Taiwan and elsewhere in the Pacific Basin, and they have since lost those markets and have had to move on and concentrate on other things.

I am concerned about misguided government policies destroying American industry. We have seen the Jones Act, which was conceived to help save the U.S. Merchant Marine, have the effect of making the Merchant Marine price itself out of the world market and virtually destroy the U.S. Merchant Marine.

We saw the Smoot-Hawley tariff destroy the export markets. So no wonder farmers, who back in the 1930's depended on export markets for about a third of their business failed after Smoot-Hawley wiped out their export markets. That tariff wiped out export markets for manufacturers and many of them went bankrupt. Many of the banks which were heavily loaned out to these enterprises, failed too.

So I am much more concerned about misguided government policies destroying industries than I am about people who are trying to sell American consumers things they apparently want to buy.

Senator SYMMS. Thank you.

Chairman CHILES. Senator Sasser?

Senator SASSER. Thank you very much, Mr. Chairman.

Dr. Tolchin, I want to commend you on the book that you and your husband have written. I think this book, "Buying Into America," is a very, very important volume, perhaps one of the most important books written this decade. I agree with the statement that William Safire made, which he says buy into this book. I think people ought to buy into it. I think it opens our eyes to the possibility of the danger of foreign firms getting undue influence over our economy and over our political process.

As I read the book, you are not saying that is a fact at the present time. You are simply stating the facts and raising the possibility that this is something that ought to be examined.

Now, in my own State of Tennessee, I well remember when the Japanese came into our State in a big way. They came in as a result of competition between the various States. And the States were falling all over each other as to who could do the most for this foreign industry coming in. I remember when Nissan came into Smyrna. The State government was building roads; wastewater treatment plants were being built; the State of Tennessee was training Nissan workers at State expense; very substantial expansion of fire and police forces at the local level. All of these funds flowing out of the taxpayers' coffers in the State of Tennessee to attract this particular industry in there.

I was struck by whether American industry going into other countries, particularly in Japan, would have been treated in the same fashion. The same with Komatsu when they attempted to open up a facility in Chattanooga, and subsequently did, creating 250 jobs. As you point out in your book, they applied for an urban development action grant to assist in locating Komatsu, the second largest manufacturer of earth-moving machinery in the world, to assist in their location in that Chattanooga market.

Now, my question to you is: Do you know of any comparable programs in Japan comparable to the UDAG programs or local governments in Japan seek to lower the expenses of American industries coming in there to locate, to your knowledge?

Dr. **Tolchin**. No, I do not. My impression of Japan is that they are more restrictive, much more restrictive than we are about foreign investment. Very often, although there are now many American firms operating in Japan, the welcome mat is not nearly as large as it is in this country.

Indeed, there was an agribusiness in the middle West, Cargill, that wanted to put up a plant in southern Japan. Cargill attempted to put a plant up in southern Japan, and the reception they got was a royal run-around. The local prefecture said they needed a permit from the central government; the central government said they needed a permit from the local prefecture. And it took the intervention of Senator Danforth and the U.S. Trade Representative to pressure the Japanese Government to let this company in, and it took a long time before this U.S. multinational could locate in Japan. So not only don't they give them roads and grants and UDAG grants and tax holidays, but they put up barriers as well.

Now, when you see that this happens to a U.S. multinational, a large company with lots of political influence, how about the smaller investors? I do not imagine they could muster the resources to break down some of these barriers. Well, they may if they are soft drink manufacturers and so on, but if it is an industry that Japan does not want or an industry that Japan wants to keep within its own borders, like many high tech industries, like petroleum, like leather, fisheries and so on, the barriers are enormous.

I think this is starting to have political consequences in this country. The mayor of Flat Rock, MI, was turned out of office after he brought Mazda to Michigan, to his city. The voters discovered that he gave them a 14-year tax holiday, and they asked, why does this rich multinational need a 14-year tax holiday? The political consequences were evident. The mayor was turned out of office.

Senator **Sasser**. Well, speaking of political consequences, after Nissan came into my State—and I hasten to add that Nissan is now a very valued corporate citizen of the State of Tennessee. But there was a little matter called the domestic content legislation that was pending here in the Congress, and that required that automobiles assembled in this country have a certain amount of American parts.

Speaking from experience, Mr. Chairman, personal experience, I was neither a supporter nor an opponent of that legislation, but I was examining it.

Chairman **Chiles**. That is a stance I have seen you take on a number of bills.

Senator **Sasser**. I ultimately came down on the side of the domestic content bill, and I will tell you why: Because I thought it would be well if Nissan looked down the road to the Ford glass plant to get the glass for their automobiles, about 50 miles from their plant. I thought it might be well if they looked to the Goodyear Tire Company in Tennessee that employed Tennessee people to get their tires, et cetera. But before I could even make up my mind on the bill, because I did not join the rush to be in opposition to the domestic content bill, I found myself suddenly being opposed by

Nissan executives who were raising political funds for my opponent.

This, I thought, was an example of a foreign corporation attempting to exert political influence in my particular State, and I can testify to that.

Dr. Tolchin, do you find that in other areas of the country in your research? Foreign corporations attempting to exert political influence over elected officials?

Dr. **Tolchin**. Yes; I am glad you mentioned that, because I indicate at the beginning of my remarks that your experience was the inspiration for this book. The more we looked, the more signs of influence we found.

Many Representatives and Senators here have told us that they feel that they cannot take the position that they would normally take on trade legislation because of the heat they are getting from foreign investors back in their home States. So I think that is evidence; that is very serious evidence. Because when foreign corporations come to this country, again, being American and being generous hosts, we treat foreign corporations exactly the same as we treat U.S. corporations. We really do practice national treatment, not only legally but in terms of our political reception to these companies.

Foreign companies get exactly the same political protection as their U.S. counterparts, even despite the fact that the profits may return home and hurt our trade deficit. But, again, because they are accorded this equal political treatment—equal, indeed in many cases preferential political treatment because we want them to stay here—they feel no hesitation lobbying our political system, which is also more open than other systems to this kind of influence.

We have seen this. I mentioned the case of the unitary tax where you had heads of State lobbying State legislators and lobbying our President on an issue of State tax policy. Prime Minister Margaret Thatcher went to see President Reagan personally to get his intervention on the repeal of California's unitary tax, and she went further than that. She got Parliament to pass a resolution saying they would retaliate or give her the power to retaliate against U.S. corporations if we did not follow their bidding on this State tax policy.

That is a very good example of political influence. Ironically, you might be interested to know that we discovered a letter from President Reagan that he had written when he was Governor of California to the Senate, to the Senate committee studying the unitary tax repeal, opposing the repeal of the unitary tax, in effect, telling the Senate to lay off. He said, "This is a violation of my State's sovereignty."

So, really, where you are is where you sit. As President, he assumed another role, and intervened to get the governor to support the repeal of the unitary tax. So, yes, the answer to your question is very definitely, and I expect to see a whole lot more of it as we see this increase in foreign investment.

Senator **Sasser**. My time has expired.

Chairman **Chiles**. Senator Symms.

Senator **Symms**. Thank you very much. Mr. Chairman and Senator Sasser, I just wanted to say that from 10:30 to 11:00 the Basque president is over in the Capitol, and Idaho has the second largest population of Basques outside of the Pyrenees. I want to ask your pardon, but I must go over and visit with him.

So thank you very much, Mr. Chairman.

Chairman CHILES. Is that the large-mouth Basque or small-mouth Basque?

Senator SYMMS. The same kind of Basque as Senator Laxalt. [Laughter.]

Thank you very much. I enjoyed your testimony. I would like to stay and keep on asking questions all morning. I find this very fascinating and very challenging.

Chairman CHILES. Dr. Tolchin, there is an interesting article in Friday's Washington Post about a forthcoming book by Clyde Prestowich. It seems he has confirmed what a lot of us have suspected for some time, that when it comes to trade policy, the administration has literally been asleep at the wheel, and all these get-tough trade initiatives and strike forces were primarily just for public relations.

Now the administration is telling the trade conferees that they have to get rid of all the provisions that limit the President's discretion.

I am not sure any administration should have the discretion to totally sleep through its watch. From your perspective, what risks are created by this lack of a coherent trade and investment policy? What are the danger signals you see on the horizon? How should America respond?

Dr. TOLCHIN. I think this administration has been, as you say, both proponent and practitioner of laissez-faire investment policy. I am more familiar with investment policy, so I will talk more about that. But I think that they have been almost inactive in this field, saying that all of this investment coming into the country is a sign of U.S. economic health.

Well, if this is health, I would hate to see sickness. I think what we are doing, in effect, is selling off the roof to pay the mortgage, by selling so many of our vital assets to foreign investors.

Even though they have been laissez-faire in terms of direct investment, in acquisitions, and so on, they have been proactive in terms of trying to attract foreign money to buy our T-bills. In 1984, for example, Secretary Regan made Treasury offering more attractive to foreign investors by eliminating withholding tax and designing these issues to provide anonymity for foreign investors.

They have been proactive in trying to sell T-bills to prop up the deficit and get us out of economic trouble. I am not sure that this is a sign of U.S. economic health.

They have been absolutely laissez-faire in terms of direct investment, and this is where the Federal Government could come in. And I think that, when you look at how other countries deal with direct investment, our major industrialized trading partners, you wonder what they know that we do not. We are the only country practicing free trade and free investment, while other countries are practicing a very refined form of strategy. They know what they are doing, and they are operating as nation-states.

We are operating as 50 separate units, and here is where the Federal Government could come in and make a contribution. The Federal Government could at least coordinate the efforts among the States so that the States are not giving away the store and losing vital assets, taxpayers 'money, to subsidize foreign investment.

I think we have got to stop this economic war among the States, and I think the States themselves want to stop it. The Governors themselves are concerned. They don't want to give away these assets if they don't have to, and they are gradually coming to the realization that they do not have to give away more than they absolutely have to give away.

I think we have to do something about stopping these giveaways or at least coordinating them, because North Dakota cannot compete against Japan. There is no question that this is getting us into big trouble by allowing the States to in effect conduct their own individual foreign economic policy, without anyone there to coordinate and monitor that.

Secondly, I think we have to improve disclosure. There is no question in my mind, the more I study this, the more serious this problem is.

Disclosure does not mean restriction. That is a big mistake. The most commonly heard argument that I have heard against the Bryant amendment is that improved disclosure will ultimately lead the government to restrict foreign investment. I do not believe that is so. I think if we have to restrict foreign investment, it ought to be in the national security area; or, if we determine after seeing all the data, if we get correct data in the future, then if it is hurting business unfairly, then I do think we have to take some steps to at least look at it and perhaps restrict it if it is unfairly hurting American interests, both security and economic interests.

I think improved data collection is really important.

We have to negotiate. I think you are absolutely right, Senator Chiles, there is no reason in the world we should not negotiate with a firmer hand. Other countries do, and I think we are making a mistake in not demanding investement reciprocity from other countries. It does not have to be strict, tit-for-tat reciprocity, but if we allow countries to operate here with an open door, there is no reason in the world we should sit back and tolerate restrictions on our investments abroad.

Chairman Chiles. You think it would be a good idea to demand some kind of equal treatment for our American investors.

Dr. Tolchin. Absolutely. I mean, for example, we allow the Kuwaiti Petroleum Co., which is a wholly owned subsidiary of the Kuwaiti Government, which acquired the Santa Fe Corp., to drill for oil on U.S. land. We cannot drill for oil in Kuwait—wouldn't we love to drill for oil in Kuwait?

Senator Sasser. While we pay $250 million a year to protect 10 Kuwaiti oil tankers, shipping oil principally to Japan.

Dr. Tolchin. That is right.

But the law says that as long as Kuwait discriminates against everybody, it can discriminate against U.S. investors. Not only can't we drill for oil in Kuwait, but we can't buy Kuwaiti assets without a majority Kuwaiti partner.

We have got to start looking at these questions. We may not want to demand the right to drill for oil on Kuwait, but we certainly can demand a whole lot of other things in terms of freedom of investment in Kuwait.

Chairman CHILES. So we ought to consider investment opportunities, or closing them, unless we are offered similar opportunities, quid pro quo.

Dr. TOLCHIN. Exactly.

Certainly, there might be an excuse to allow less-developed countries to practice certain forms of protectionism in investment while they are developing, but there is absolutely no excuse to allow it from countries with whom we have huge trade deficits.

Those few suggestions would be a step in the right direction.

Chairman CHILES. That is right. Part of our problem is we do not know how to wean them. If you look at South Korea, or you look at Taiwan, when they become tigers, we are still milk-feeding them.

Dr. TOLCHIN. It is curious to me that any time you criticize Japan or Korea or any of the Pacific Rim nations, or any foreign nation, you are accused of being a racist or a xenophobe or protectionist and so on. Throwing labels like this around and name-calling hurts us, because it prevents us from looking at the real issues.

It is easy to use these terms when they are meaningless and they have no substance to them. I think this is another example of letting others formulate the issue. People are so afraid to criticize other countries for fear of being called names that they don't, and this prevents us from moving ahead and protecting our interests.

Mr. POWELL. May I comment, Senator?

Chairman CHILES. Yes, sir.

Mr. POWELL. A number of points come to mind. First of all, this whole focus has been on the buying of America and foreigners getting foreign assets. But what about the assets that we got in return? We have gained $1 trillion from foreigners in value-for-value exchanges. We have not lost anything. We don't trade to make ourselves worse-off.

The United States, particularly the private sector, has gained $1 trillion. What has happened with that? In the last 5 years, the adjusted return on equity in American corporations has improved 30 percent. We are apparently making more effective use of the resources which we get.

And, as I have already mentioned, we are using this capital to create jobs. So again I ask: Where is the damage? All the complaints about the lack of disclosure and so on betray, I believe, a colossal paradox. The paradox is that we cannot tell by looking in the marketplace who owns what.

Is the Japanese product the one that is so well-made and offers good value? Not necessarily, because there are many well-made American products. You cannot tell what the Jewish building is because they are in a competitive marketplace. It makes absolutely no difference. There is no sense in discriminating.

As long as everybody has alternatives in a competing marketplace, we won't be able to tell who owns what, and it won't make any difference. If somebody puts out a shoddy product, the Consumer Product Safety Commission or the Federal Trade Commission may step in regardless where a product is made. At the point when somebody is actually harmed, we have abundant mechanisms available to take care of it. But until that point, what difference does it make who owns what?

We should not be advocating discrimination on the basis of race, creed, color, or national origin.

Chairman CHILES. Well, Mr. Powell, one of the things that kind of bothers me—you say there is only 5 percent foreign ownership now; there was only 2 percent a couple of years ago. At what stage are we supposed to get concerned?

Mr. POWELL. At what point does it make a difference?

Chairman CHILES. Yes.

Mr. POWELL. It doesn't make a difference.

Chairman CHILES. Fifty percent does not bother you, either?

Mr. POWELL. As long as it is free entry, and consumers are free to buy whatever products they want, and employees are free to switch jobs, and suppliers are free to move, and tenants and landlords are free to do business with whomever they want.

We have a myth—there is absolutely no correlation between the size of companies, the concentration of industries, and their hold on the marketplace. We saw IBM, which had a commanding——

Chairman CHILES. Let's don't talk about a company, but let's talk about sectors. Is there something about sectors? Let's take the semiconductor sector of the market. Let's take high-tech electronic sector of the market. Is there not some concern there? Do we want to not be in that entirely? Are we ready to give up on that?

Let's not talk a company, but a whole sector.

Mr. POWELL. Well, which sector do you want to help and which do you want to hurt?

Chairman CHILES. I think it is wise for this country to be in semiconductors. I think it is wise for defense; I think it is wise because we know that is what will drive the next range of products. If we do not stay in that, or if we allow somebody to keep us down because they keep our products out, or they can set the prices on that market, I think that can be harmful—the fact that our consumers can go and buy semiconductors. I guess our Defense Department can go try and buy them for our black box things. But to me, it seems like we need to have some kind of viable market there.

Mr. POWELL. Is it in our national security to be in computers? Because of efforts to intervene in the marketplace and protect less-competitive semiconductor companies, it is directly penalizing other Americans in the computer industry. The September 1986 semiconductor agreement contributed to the recent quadrupling in the price of memory chips, which has hit the U.S. computer industry at the worst time. U.S. computer companies have introduced new, memory-intensive products to hopefully set business back from the East Asia clone computers. But by pushing this semiconductor cartel—which has benefited only two companies—the U.S. Government has induced a shortage and price escalation of memory chips, suppressing U.S. computer sales. According to the Brookings Institution, a 10-percent increase in computer prices results in a 15-percent drop in computer sales.

Meanwhile, the biggest profits are going to the Japanese who make 90 percent of memory chips. Now they are plowing their profits into advanced R&D, so they will keep ahead. This is as global market, and the way we increase our security, increase our prosperity, and create more jobs is to let each individual participant go where they can buy the best deals, find the market niches that they can. And to limit the ability——

Chairman CHILES. But what I am saying is doesn't it bother you at all that it is not a fair playing field that we are on. They do not allow us to do that, but you are saying regardless of what they do, you let the good times roll here, that we should not put any restrictions up here.

Mr. POWELL. It is not a matter of what we choose to do. It is a matter of what consumers choose to do. Is it fair to prevent consumers from buying from one supplier to go to another supplier, because consumers are the ultimate guardians of the marketplace. We vote with our dollars every day in our capacity as consumers, and to impose restrictions, you first of all overcharge American consumers, you destroy the jobs in companies which would otherwise have gotten money from consumer choices, and you undermine the competitiveness of American companies in the global marketplace by making it more difficult for them to acquire the capital, the resources, or whatever it is they need.

Chairman CHILES. I am a consumer. But to me, that is not the only thing that this country should be concerned about is protecting or allowing consumers. There has got to be some other reason for being the United States of American than that we are protecting consumers. There are some other national goals that we have other than protecting consumers.

Mr. POWELL. Well, in the United States, individuals are sovereign. That is what the country was founded for, to make individuals, rather than rules, sovereign. In the marketplace, consumers should be sovereign.

Chairman CHILES. But every right I give up in my individual sovereignty, I am giving up because there is some greater goal that we band together—national defense, certain national goals that we have. We have to look to those, and we feel that there are certain national policies that we should have.

I look forward to your book, Mr. Powell. I would think it would have sold very well in the British Empire days, because they needed a spokesman as good as you are, I think, to justify a lot of the colonization and things that they were doing back then.

Mr. POWELL. Oh, they had a much better spokesman than I, Mr. Chairman. Adam Smith wrote his great book, *The Wealth of Nations,* precisely to demonstrate how the mercantilist, protectionist policies of Great Britain were impoverishing that nation. His argument for free trade was that it would make the country pursuing free trade more prosperous.

There is no theory. It is simply the common sense idea that it is better to buy things cheaply than expensively; that free trade lowers the cost of goods and capital, that it creates more jobs.

Chairman CHILES. I like that idea, but I think you just have to couple it with that what is sauce to the goose has got to be sauce to the gander. There has got to be a free sort of market where your competitors or those people who are coming here, have to play by the same ground rules. If you allow them to set the rules and pick the turf, while we totally open markets—which is the thing we have done for them—I just don't think that that can work out.

Mr. POWELL. Well, we are not doing it to do favors for other people. It is in our self-interest to open our markets. Ten years ago, Lee Iacocca said the Japanese should come here and build——

Chairman CHILES. But the Japanese think it is in their self-interest to close some of their markets, and they have convinced me that, by golly, they are right.

Mr. POWELL. The Japanese are gradually opening their markets. The United States is gradually closing its markets.

Chairman CHILES. Only where they have decided they have this advantage; only where they have decided that they have now captured markets; only where they have decided it works in their national interest. And they have not started a trade war because of that. They have built a tremendous industrialized, highly sophisticated economy and society.

I give them all kinds of credit. But your theories, if the Japanese had followed them all the way through, they wouldn't be where they are today.

Mr. POWELL. Well, MITI did not create Japan. The private sector created Japan. Because of MITI, Japan lost the shipping industry. They would have driven Honda out of business to force mergers of Toyota and Datsun.

Chairman CHILES. But they would still be there, raising their rice and doing their fish, if they hadn't decided they were going to put together and target certain industries that they were going to support. MITI did build Japan. The private sector didn't do anything without MITI, which helped put together the capital and the know-how and the protection that all went hand-in-hand with that.

Mr. POWELL. There are no magical powers at MITI. They put tremendous resources into the Japanese shipping industry in the early seventies. The effect there was the same disastrous impact as our Jones Act. It priced the Japanese shipping industry out of the world market, and they have now less tonnage than they did when MITI started its subsidies.

Chairman CHILES. But for every loser they had, look at the winners; and the winners multiply much greater than the losers.

Senator Sasser?

Senator SASSER. Thank you, Mr. Chairman.

Let me just ask this first, Mr. Chairman. I have an opening statement; I was delayed in getting here, and I would like to have this included in the record.

Chairman CHILES. Without objection, it will be included.[1]

Senator SASSER. Over the past few years, there have been some 20 unsolicited tender offers, hostile corporate takeover offers, by Canadians for American companies. But in the same time period, there has been only one tender offer by an American for a Canadian company.

Now, the question is: Why?

Well, in large part, this is a result of a policy of the Canadian Government to deter what they perceive to be hostile takeovers of Canadian companies. And this policy is kept in place by the pending free trade agreement with Canada which expressly states that

---

[1] See p. 333.

Canada may continue to review acquisitions of Canadian businesses by American businesses.

But there is no such policy to protect American companies from hostile takeovers by Canadian companies. Indeed, some say that the Canadian policy makes our companies even more vulnerable to hostile takeover, because if the Canadian company makes a move on the American company, our companies cannot exercise the defense of trying to acquire the acquirer, the so-called "Pacman" defense.

Now, about a month ago, I wrote to the Chairman of the SEC, raising questions about the fairness of this Canadian policy and its effect on U.S. companies. I wrote out of concern over the Campeau offer for Federated Department Stores, a significant employer in the State of Tennessee. I have not yet gotten a response from the SEC, but I would like to get the comments of both of our panelists on this particular policy in the Canadian Government vis-a-vis that of the United States Government with regard to hostile takeovers.

Dr. Tolchin?

Dr. TOLCHIN. The Canadians, as you know, have always had a review board, (FIRA) Foreign Investment Review Agency, which up to just a couple of years ago, reviewed all foreign investments coming into Canada and rejected the ones they felt were undesirable.

They have replaced FIRA with something called "Invest in Canada", which sounds much friendlier; it sounds as if they want foreign investment in Canada.

It is interesting that although it has a positive face the agency still, as you point out, retains many of the restrictions that they formally had. You read in the language that Canadians are very concerned with intellectual property; they want to retain their cultural identity. This gives them an excuse to exclude movies, books, and publishing houses from liberalized trade and investment policies.

You are absolutely correct: It appears that the Canadians still do restrict more than we restrict Canadian investment.

In terms of hostile acquisitions our government could certainly play a more vigorous role in screening out those acquisitions that are not good for the country. I think of one that immediately comes to mind. Sir James Goldsmith——

Senator SASSER. He was going after Goodyear.

Dr. TOLCHIN [continuing]. Yes—I think he has got dual nationality (British and French). Goldsmith made an offer to acquire Goodyear, and in order to protect themselves, the executives of that company had to pay him $93 million in greenmail. Well, that is $93 million that left this country, potentially left this country.

Not only do we have our own problems with hostile takeovers when corporations are destroyed by it, but we now have to face this from hostile foreign takeovers, which will mean a dent in our trade deficit as well.

Senator SASSER. Mr. Powell, do you want to comment on this matter? We talk a lot about trade deficits with Japan and Korea, but as I am sure both of you know, our largest trade deficit is with Canada.

Mr. POWELL. Thank you. I would say that just because other countries close their harbors is no reason for us to put rocks around our coasts.

I completely agree that the restrictions in Canada, Japan and elsewhere are bad. I would advocate removing them.

Chairman CHILES. How?

Mr. POWELL. Private negotiation—because for the government to intervene increases the penalty on Americans.

Moreover, there are very few cases anywhere to support the notion that closing a market, or threatening to, will lead other people to open their markets.

Chairman CHILES. I don't see any reason the Canadians or anybody else should remove any restrictions to private negotiations, if we are not ever going to play hardball—

Mr. POWELL. Well, playing hardball means restricting foreign bidders from the United States. The impact is to reduce the value of American companies. Now you are getting back to the harm done against Americans. So it makes absolutely no sense to me to retaliate with the kinds of restrictions and barriers which will have the primary damage on Americans. You are talking about helping one group of Americans and hurting another group of Americans, and that is unfair.

Senator SASSER. I am going to have to leave this hearing and go to a hearing of the Banking Committee, of which I am a member. The Banking Committee is holding a hearing this morning on the Community Reinvestment Act. The Community Reinvestment Act requires that banks lend to some degree in the communities in which they are located. I have read the statements from the witnesses this morning. The testimony indicates that for years, smaller, locally owned banks do a better job of meeting the credit needs of local communities because they have an interest in the communities they are from. I think we will all agree that banks play a pivotal role in our economy. Their ability to dictate credit flows can have an enormous impact on the economic development, not just of a community but also of a country.

Now, the record shows that large banks are less community oriented. That is what the Banking Committee is going to hear this morning. And we have an emerging trend in this country toward larger banks, interstate bank mergers, hostile takeovers of banks, that will lead to larger and larger banks.

Now, certainly, a foreign-owned bank, it would appear to me, is going to have less of an idea of the special needs of a community than a large bank that is domestically owned or a community-owned bank. And Dr. Tolchin, I think you testified before I arrived here this morning that something like 12 percent of domestic bank assets in this country are now held by Japanese banks.

Dr. TOLCHIN. Yes, 21 percent of our Nation's banking assets are foreign-owned; and the Japanese are moving in. In California, the Japanese own now 5 of the State's largest 10 banks.

Senator SASSER. Well, if what we are hearing before the Banking Committee is that locally owned banks are much more responsive to local needs than larger banks that come in across State lines, if the Bank of Bradenton, Mr. Chairman, is more responsive to Bradenton than Citicorp would be if it came in and bought the bank, what about the Bank of Tokyo if it comes in and buys these banks? What does that say about economic development here in the United States and even more so, when you peel it back and find that the Japanese banks control and dictate the industrial policy of many of the large Japanese industrial firms? What does that say about the economic prospects for these communities?

Do either one of you want to comment on that?

Mr. POWELL. If a bank is sensitive to local concerns, it will get more business. We shouldn't have laws which restrict competition between banks from trying to be sensitive to local needs.

I believe that the branch banking laws should be repealed, laws which restrict entry into different States should be repealed, so that local people will have as much choice as they can about where to put their assets, where to borrow money and so on.

I believe that the banking system will be greatly strengthened by allowing banks to diversify their funding sources and to diversify their lending. And as we have seen in recent years, the banking laws which have restricted the ability of banks are in large measure responsible for the problems of banks, the reason why banks in some areas of the country are so loaded down, for example, with bad agricultural loans or energy loans or whatever was in their sector.

Continental Illinois got in trouble partly for the same reason——

Senator SASSER. Well, Mr. Powell, you know, there is little regulation on our banks with regard to international loans, and when we look at a major threat to the banking structure in this country, it comes from the loans that were made principally south of the border. This is a situation where there was little regulation, and the banks themselves were the author of their own misfortune.

So I would differ with you on the question of regulation getting the bankers in a jam. They are fully capable of getting in a jam on their own, without the regulators helping them.

Mr. POWELL. There are a number of policies which have contributed to over-lending in the third world. One that I might mention is Federal Deposit Insurance, because Federal Deposit Insurance costs the same for any bank regardless of the credit-worthiness of the bank. There is no incentive for banks to behave in a more prudent manner. There is no signal being sent to tell these banks that they are crazy to loan money to Poland and some of the Latin American dictatorships and so on. They suffer no penalty.

If banks are made to bear the full cost of their decisions, they would be more careful and make fewer bad loans.

May I comment on a point that was earlier made about the States competing with each other? I believe that there is absolutely nothing wrong with States competing to offer job-creators a better business climate.

There seems to be an attitude that the money we earn belongs to the government unless the government decides it does not want it.

Our earnings belong to individuals. It is not for the government to give away. We talk about the preposterous unitary tax in California as if the State of California has a preemptive right to our earnings. The State does not have that right.

It is ridiculous to say that the unitary tax was a foreign banking issue. What a preposterous claim for a State to assert a claim on any company's worldwide earnings. By what stretch of the imagination does the State of California have a claim on income which IBM has earned in Japan or Tennessee or Paris?

The counter-claim that if you abolish the unitary tax, then the multinationals are going to shift their assets to lower tax havens obviously reveals the fact that lower tax environments, less onerous regulatory environments, encourage business and attract jobs.

So I absolutely agree it is not a good thing to have States subsidizing other companies, taking money from some people and giving it to special interests, but on the other hand, if you are talking about eliminating obstacles—the argument is made, for example, that some regulations are onerous, and the foreigners are exempt from them—well, the logical step is to eliminate the obstacles so they don't apply to anybody.

But what we are hearing is that the fairest thing to do is to force everybody under the same yoke.

Senator **Sasser**. Dr. Tolchin, do you want to comment on my question?

Dr. **Tolchin**. Yes; I will restrict my answer to banking and not address the unitary tax issue.

The banks are the backbone of this country and very important to development, the growth of the Nation and its industries. The banking industry is a very good example of where U.S. law disadvantaged our own banking industry and allowed foreign banks to come in and corner a large part of the market share. Before the International Banking Act of 1978 corrected this inequity, our banks were prohibited from engaging in interstate banking while foreign banks could. And during this period before this inequity was corrected, foreign banks were able to move in and really make their biggest push toward acquiring a large part of our banking business.

Also, the fact remains that many foreign banks can own industries; our banks cannot. They often purchase T-bills. They are owned by governments. And of course, the banks that are located in capital surplus nations, where they are often synonymous with the government, can be expected to come in and increase their market share even more in the forthcoming decade.

My question is, should there be a ceiling? Right now, when we finished writing our book, foreign banks owned 17 percent of the Nation's banking assets. In about a year's time, that has climbed to 20.9 percent.

What happens when it goes to 50 percent or 80 percent? Should we as a government and as a Nation determine a ceiling? Is it desirable? It is in the interest of this country to have so much of the banking industry, which is the spine of the Nation, controlled by interests outside our borders, or are we in fact still a nation-state operating as a nation?

Senator **Sasser**. Thank you very much. I think you hit the nail on the head when you ask the question are we still a nation-state operating as a nation. Is that still the reality of the world in which we live? I think when we hear all too much of these cries for totally free trade, lack of reciprocity and let the market govern. If we lived in a utopian world, that might work. But we live in a nation of individuals that look primarily to their own self-interest. This is good in many respects I think but it is going to continue to dictate economic and diplomatic conduct of this Nation and other nations at least into the foreseeable future.

Mr. Chairman, I would like to continue this discussion longer, but I have got to get to the Banking Committee. I do want to thank you for convening these hearings this morning. They were most informative and provocative on occasion.

Thank you.

Chairman CHILES. Thank you, sir.

[The prepared statement of Senator Sasser follows:]

PREPARED STATEMENT OF SENATOR JIM SASSER

MR. CHAIRMAN, A FEW YEARS AGO FOREIGN INVESTMENT IN THE UNITED STATES WAS CONSIDERED TO BE ENORMOUSLY IMPORTANT TO OUR ECONOMIC DEVELOPMENT. IT WAS ENCOURAGED BY GOVERNMENT, BY BUSINESS, BY CIVIC LEADERS ACROSS THE SPECTRUM. NOW, WE HEAR INCREASINGLY THAT FOREIGN INVESTMENT THREATENS OUR POLITICAL, SOCIAL AND ECONOMIC INDEPENDENCE. AND IT SEEMS THAT FOREIGN INVESTMENT HAD AN IRREVERSIBLE MOMENTUM.

I HOPE THIS MORNING THAT WE CAN GAIN A GREATER UNDERSTANDING OF HOW WE ARRIVED AT THIS SITUATION, AND WHAT IS THE BEST COURSE TO FOLLOW IN DEALING WITH IT.

CERTAINLY, OUTRIGHT RESTRICTIONS ON FOREIGN INVESTMENT WOULD BE FOOLHARDY -- THEY COULD CAUSE A RECESSION. BUT, FOREIGN INVESTMENT APPEARS TO BE ONE MORE COMPELLING ARGUMENT FOR THE LONG RANGE GOAL OF GETTING OUR FISCAL HOUSE IN ORDER. WE ARE TOO

DEPENDENT ON FOREIGN CAPITAL TO FINANCE OUR OVER-CONSUMING ECONOMY.

THERE ARE AREAS, HOWEVER, WHERE I THINK WE CAN MAKE IMPROVEMENT, EVEN IN THE SHORT TERM. I THINK THAT SOMETHING SHOULD BE DONE TO MAKE OUR COMPANIES LESS VULNERABLE TO HOSTILE TAKEOVERS -- BOTH FOREIGN AND DOMESTIC. WE ARE SEEING AN ENORMOUS AMOUNT OF LEVERAGING IN THE ECONOMY, MUCH OF THIS IS THE RESULT OF THE TAKEOVER CRAZE. THE DEBT BURDEN KEEPS OUR COMPANIES FROM FOCUSSING ON THE LONG TERM, FROM MAKING PRODUCTIVE INVESTMENTS. IT WILL MAKE MANY LARGE COMPANIES VERY VULNERABLE IN THE NEXT BUSINESS DOWNTURN.

INDEED, WHEN FOREIGN BUSINESSMEN SUCH AS AKIO MORITA, THE PRESIDENT OF SONY, CRITICIZE OUR ECONOMY, THEY IMMEDIATELY POINT TO OUR OBSESSION WITH MERGERS AND ACQUISITIONS AND THE DETRIMENTAL IMPACT THIS OBSESSION IS HAVING ON OUR PRODUCTIVITY. CERTAINLY, LARGE HOSTILE ACQUISTIONS OF AMERICAN COMPANIES BY

FOREIGNERS ARE AMONG THE MOST VISIBLY NEGATIVE SIGNS OF INCREASING FOREIGN INVESTMENT. BUT MAYBE THIS IS A DOMESTIC ISSUE AND ONE THAT CAN BE CORRECTED WITHOUT ACTION AGAINST FOREIGNERS.

I WELCOME MS. TOLCHIN'S TESTIMONY. SHE HAS DONE SOME EXCELLENT RESEARCH AND HAS MUCH THAT'S TO SAY ON THIS SERIOUS ISSUE. THANK YOU.

Chairman **Chiles**. Senator Grassley.

Senator **Grassley**. Yes, and even though I did not hear the testimony, I can tell from the discussion thus far that everything Senator Sasser said is true about the very important issue that has been discussed at this meeting, and so I thank you, Mr. Chairman.

I have just one question, and I want to avoid whether or not there ought to be investment in the country or discouraged or encouraged. But what I have had problems with over a long period of time is the argument of some who want to encourage investment in this country saying that the reporting of that investment is bad.

So my question to both or either of you is whether or not there is any objective measure of the impact on financial markets, or maybe even any other economic impact, of increased reporting requirements for foreign investors in this country.

Dr. **Tolchin**. We do not know yet, since we have not had any increase in reporting requirements. Our reporting requirements are very lax——

Senator **Grassley**. Well, I mean even what reporting requirements we have.

Dr. **Tolchin**. Yes. Of the reporting requirements we have, there has been absolutely no impact either way—negative or positive impact either way that I can see. It hasn't discouraged it, and it hasn't encouraged it. It has been in place so long, we have not had any changes.

Senator **Grassley**. Mr. Powell.

Mr. **Powell**. We do not need foreign entities or any entities to pull out in order to see a difference in the marketplace. We just need to do enough things to slow the flow.

Last April, for example, when commodity prices started going up and there were increased fears of inflation in the dollar, foreign investors simply slowed down their additional investment in the Treasury markets, and within 30 days, interest rates jumped up 2 percent. And because home mortgages are now closely linked through the mortgage-backed securities markets, homeowners across the country with variable-rate financing found their household costs went up.

The money was still coming into the marketplace; the flow simply slowed down. And once again, when conditions changed in June, the dollar had stabilized and so on, the return of foreign investors to the bond markets coincided with a tremendous bond market rally.

So when we talk about threats of foreigners to pull out and so on, we are obviously talking about a graded scale; you introduce some restrictions, you make a few more people pull out; you introduce more restrictions and more costs and so on, and a few more people pull out. Eventually, you get serious retaliation.

Senator **Grassley**. You are saying reporting requirements are negative on investment in this country; is that what you are saying?

Mr. **Powell**. On the impact of foreign investment.

Senator **Grassley**. Yes.

Mr. **Powell**. Oh, the impact of foreign investment has overwhelmingly been official in this country. I was answering the question of what difference does——

Senator **Grassley**. No; I'm sorry.

Mr. **Powell**. Perhaps I misunderstood. I was addressing the issue of what impact can we see.

Senator **Grassley**. I am talking about just if we want to know how much and what kind and where it is of foreign investment in the United States; does that have a negative impact, from your point of view, on investment in this country? Does it discourage investment?

Mr. **Powell**. Well, the Bryant amendment imposes reporting costs on—it discriminates against foreign countries. It imposes reporting requirements which we do not make of private U.S. corporations. If you review the impact on consumers, on creating jobs, on the competitiveness of companies of foreign investment, and you see that there are enormous benefits that flow from additional capital being made available, the more capital that is available in America, the more jobs will be created in America, and the faster wages will rise. And we are seeing that wages are rising fastest in the top end of the wage scale in the United States.

We are receiving the benefits of foreign capital. Why do anything to discourage it? Why drive the capital away? Do we want more jobs to be created in this country or someplace else? We ask what do the Europeans know that we don't know. Well, one thing they do not know how to do is create jobs. You have not had much job creation in Europe for 10, 20 years.

In this decade, we have produced 2½ times more jobs than Europe and Japan combined. I think we want to repeat success and not impose the restrictions of other countries which are less successful than we are.

If I might, Senator, the issue of how threatened should we feel from size, from foreign penetration of banks and other industries: there is absolutely no correlation between market share and monopoly power as long as there is free entry. We have seen, for example, in the 1940s in this country, the dominant companies in the electronics tube industry were RCA and Raytheon, and they seemed to be the ones that would dominate the market and dictate policy in the future. But it was a company out of left field, Texas Instruments, which introduced better technology, and they became the new giant, and it looked like they were gaining market share, and they were going to go on forever——

Chairman **Chiles**. Well, back to the Bryant amendment, doesn't the Bryant amendment ask much less information for a foreign company than we require of our own publicly held companies?

Mr. **Powell**. Well, the Bryant amendment would require that information of private companies that do not raise public funds. Foreigners coming in, creating jobs——

Chairman **Chiles**. But I am saying of our American publicly held companies, who also have consumers to deal with—we are asking for much less information than we require of our publicly held companies.

Mr. **Powell**. And why? Who has violated the law? We do not see foreign investors coming in and raping women and stealing things or burning buildings. They are offering consumers products they want to buy. If they commit a crime, then we apply the established laws.

Chairman **Chiles**. Mr. Powell, we did not say they were committing a crime. We just said we would like to know who they are, how much they are buying, where they are buying it. Is that not something that sovereign nations ought to try to know?

Other countries do that with our investments, most of the industrialized countries——

Mr. **Powell**. And we are more successful than they are.

Chairman **Chiles**. And then you turn around and say we are talking about them raping our women. Hell, no, I did not say that. I just said we want to know what is the penetration; where is it coming—just information. This is an information age in which we live. And we are going to go blindly—we are supposed to just travel blindly forever? That does not make sense to me.

Mr. **Powell**. Why do we care who owns something if no damage has been done?

Chairman **Chiles**. No damage has been done. That is interesting. It has not been done perhaps now, but at what stage do we know when damage would be done if we do not have information? That is kind of like saying why should I go to the doctor and take an x-ray, because I do not feel bad, and there is nothing wrong, so why should I ever take a chest x-ray—because I want to know whether I might have something in my chest. So I go to the doctor. That is not raping our women or anything else. I just want a little information about my chest.

Mr. **Powell**. The IMF estimates there are between $50 and $200 billion of capital around the world which is unreported income, a lot of that from investors in countries where you have political oppression and excessive taxes and other unfavorable environments. A lot of that money, it is reasonable to suppose, is here, refugee capital.

Certainly, the reporting requirements would encourage those people to take their money away. They would also encourage plenty of private companies——

Chairman **Chiles**. So we ought to be the haven for the drug money that comes in; we want to be the haven for this; is that what we are seeking?

Mr. **Powell**. Well, I do not think we would say that of people who are refugees from Pinochet's Chile.

Chairman **Chiles**. You just said they were not raping our women. If it is people with drug money, they damn sure are affecting our kids, they are affecting our economy; I would like to know something about their drug money. Those people are perpetuating crimes on us and the rest of the world.

So now we are back to your example. Why do we want their money? Because they are raping our children. So I want to know where it is coming from.

Mr. **Powell**. Well, I don't think we would presume people are guilty who come from politically oppressive regimes like Pinochet's Chile. Eighty percent of the countries in the world are dictatorships, and I think we have opened the welcome mat to refugees from around the world——

Chairman **Chiles**. But you are the one who said all of this drug money is floating out there, and this illegal money, and we are going to keep some of that money from lighting here if we ask about it. I do not comprehend that.

Mr. Powell. The capital which is available from many sources—there is shipping income, there are all kinds of enterprise around the world which has nothing to do with drugs. We would lose the benefit of legitimate foreign businesspeople who have no interest——

Chairman Chiles. Well, I do not see how we lose any of that benefit, to tell you the truth, if we just ask some kind of disclosure. We are not saying do not bring your money; we are just simply saying a prudent thing for a country who knows that there is a lot of foreign investment coming in is to be able to measure, to have some kind of idea where it is coming from and who is putting it in. I do not see how we lose any money.

If every other country has those requirements now, where the hell is the money going to go if it is not going to come here? I do not understand that.

Mr. Powell. Britain doesn't require that foreign investors register or be screened by the government. France has no restrictions on portfolio investments. West Germany doesn't screen foreign investments. The Netherlands doesn't either, nor does Switzerland. More than 1,000 foreign have made direct investments in Japan. And Japanese companies have made direct investments in more than 30 countries, including Australia, Brazil, Britain, Canada, Costa Rica, France, Hong Kong, India, Indonesia, Italy, Malaysia, Mexico, Peru, Philippines, Portugal, Singapore, Spain, Taiwan, Thailand, West Germany, and Switzerland. So there are many places foreigners can invest their capital if the United States becomes less attractive.

Chairman Chiles. Well, I guess, Mr. Powell, you have not convinced me, and I know I have not convinced you. But it has been a very interesting hearing, and I want to thank you both for coming, and I look forward to seeing your book, Mr. Powell, and I am enjoying reading your book, Dr. Tolchin.

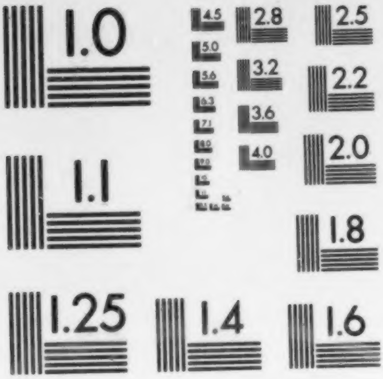
Thank you very much.

Dr. Tolchin. Thank you.

Mr. Powell. My pleasure.

[Whereupon, at 11:40 a.m., the committee was adjourned.]

O


1.0
4.5
2.8
2.5
5.0
3.2
2.2
5.6
6.3
3.6
7.1
8.0
4.0
2.0
9.0
1.1
1.8
1.25
1.4
1.6

PHOTOGRAPHIC SCIENCES CORPORATION
770 BASKET ROAD
P.O. BOX 338
WEBSTER, NEW YORK 14580
(716) 265-1600

20:1

Congressional Information Service, Inc.

CIS